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In the Supreme Court of the United States

OCTOBER TERM, 1982

CHICAGO BOARD OPTIONS EXCHANGE, INCORPORATED

and

THE OPTIONS CLEARING CORPORATION,
Petitioners,

v.

BOARD OF TRADE OF THE CITY OF CHICAGO,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT (SEVENTH CIRCUIT NOS. 81-1660, 81-2587)

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QUESTIONS PRESENTED

1. Are standardized securities options (i.e., options to purchase or sell a specified underlying security) which are widely offered and sold to the public through prospectuses and traded on national securities exchanges subject to regulation by the Securities and Exchange Commission under the federal securities laws?

2. If so, are such options subject to the exclusive jurisdiction of the Commodity Futures Trading Commission under the Commodity Exchange Act whenever the underlying securities are the subject of futures contracts traded on a commodity board of trade?

LIST OF PARTIES

This petition involves two companion cases, Nos. 81-1660 and 81-2587, in the United States Court of Appeals for the Seventh Circuit. The Board of Trade of the City of Chicago was the petitioner and the Securities and Exchange Commission was the respondent in both cases below. The Chicago Board Options Exchange, Incorporated intervened as a respondent in both cases below and The Options Clearing Corporation intervened as a respondent in No. 81-2587.*

The Board of Governors of the Federal Reserve System, the Securities Investor Protection Corporation, the North American Securities Administrators Association, the American Stock Exchange and the Philadelphia Stock Exchange filed briefs as *amici curiae* in No. 81-1660 in support of the respondents below. The Commodity Futures Trading Commission participated as *amicus curiae* in No. 81-1660 in support of the petitioner below.

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* Pursuant to Rule 28.1 of the Rules of this Court, the Chicago Board Options Exchange, Incorporated and The Options Clearing Corporation state that they have no parent companies, subsidiaries (other than wholly owned subsidiaries) or affiliates. Stock in The Options Clearing Corporation is owned in equal shares by the Chicago Board Options Exchange, Incorporated, the American Stock Exchange, Inc., the Philadelphia Stock Exchange, Inc. and the Pacific Stock Exchange Incorporated.

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CHICAGO BOARD OPTIONS EXCHANGE, INCORPORATED
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THE OPTIONS CLEARING CORPORATION,
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BOARD OF TRADE OF THE CITY OF CHICAGO,
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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

Petitioners Chicago Board Options Exchange, Incorporated and The Options Clearing Corporation respectfully request that a writ of certiorari issue to review the judgments and opinions of the United States Court of Appeals for the Seventh Circuit entered on March 24, 1982, in two companion cases (Nos. 81-1660 and 81-2587).

OPINIONS BELOW

The opinion of the Court of Appeals in No. 81-1660, which is reproduced in the Appendix beginning at page A-1, is reported at 677 F.2d 1137 (7th Cir. 1982). The order of the Court of Appeals in No. 81-2587, which appears in the Appendix beginning at page B-1, is not reported. The order of the Securities and Exchange Commission ("SEC") which was the subject of review in No. 81-1660 appears in the Appendix beginning at page C-1 and is published at 46

Fed. Reg. 15242 (1981). The order of the SEC which was the subject of review in No. 81-2587 appears in the Appendix beginning at page D-1 and is published at 46 Fed. Reg. 40849 (1981).

JURISDICTION

The judgments of the Court of Appeals, which are reproduced in the Appendix at pages E-1 (No. 81-1660) and F-1 (No. 81-2587), were entered on March 24, 1982. The order denying the timely petitions for rehearing in both cases, which is reproduced at page G-1 of the Appendix, was entered on May 27, 1982. This petition was filed within 90 days of that date. The jurisdiction of this Court is invoked under 28 U.S.C. §1254(1).

STATUTES AND REGULATION INVOLVED

This case involves Sections 2(a)(1) and 4c of the Commodity Exchange Act, as amended (the "CEA"), 7 U.S.C. §§2, 6c; Sections 3(a), 5, 6(b), 9, 17A(b), 19(b) and 25(a) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), 15 U.S.C. §§78c(a), 78e, 78f(b), 78i, 78q-1(b), 78s(b) and 78y(a); Section 16(14) of the Securities Investor Protection Act of 1970, as amended, 15 U.S.C. §78*lll*(14); and Securities and Exchange Commission Rule 3a11-1, 17 C.F.R. §240.3a11-1. The pertinent portions of the text of these statutes and regulation are set forth in the Appendix beginning at page H-1.

STATEMENT OF THE CASE

Petitioner Chicago Board Options Exchange, Incorporated ("CBOE") was organized in 1972 as the nation's first exchange market for trading in securities options. In 1973 CBOE was registered as a national securities exchange by an order entered by the SEC pursuant to Section 6 of the Exchange Act, 15 U.S.C. §78f. Since that time, CBOE has continuously maintained an exchange market for options to purchase and sell underlying common stocks and has consistently been treated and regulated as a securities exchange.

All of the options which are traded on CBOE, as well as the options which are traded on three other national securities exchanges,[1] are issued by petitioner The Options Clearing Corporation ("OCC")[2] and are publicly offered and sold to the public through prospectuses as registered securities under the provisions of the Securities Act of 1933, 15 U.S.C. §§77a-77aa.[3] OCC has responsibility for the settlement of all transactions in options which are effected on national securities exchanges and is registered with the SEC as a securities clearing agency pursuant to the provisions of Section 17A of the Exchange Act, 15 U.S.C. §78q-1.

The Government National Mortgage Association, which is a Government corporation within the Department of Housing and Urban Development, administers a program for mortgage-backed securities that is designed to increase liquidity in the secondary mortgage market and attract private sources of funds into residential loans. Under this program, these securities ("GNMA securities" or "GNMAs") are issued by private institutions, are secured by pools of mortgages and are guaranteed as to the timely payment of principal and interest by the Government National Mortgage Association. It is undisputed that GNMA securities, which are traded in the over-the-counter market and also on the Philadelphia Stock Exchange, are "securities" as defined in Section 3(a)(10)

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[1] Securities options are now traded on the American Stock Exchange, the Philadelphia Stock Exchange and the Pacific Stock Exchange as well as on CBOE.

[2] Every OCC option gives the holder the right to purchase from OCC (in the case of a call option), or to sell to OCC (in the case of a put option), a specified quantity of an underlying security at a fixed exercise price and before a fixed expiration date. All the terms of OCC options are standardized except the prices at which they are purchased and sold on the exchanges.

[3] More than two million copies of OCC's current options prospectus have been distributed since October, 1981.

of the Exchange Act, 15 U.S.C. §78c(a)(10).[4] GNMA securities are also the subject of contracts of sale for future delivery ("futures contracts") which are traded on the Board of Trade of the City of Chicago ("CBT") and are, therefore, "commodities" as defined in Section 2(a)(1) of the CEA, 7 U.S.C. §2.[5]

On April 17, 1980, CBOE filed with the SEC, pursuant to Section 19(b) of the Exchange Act, 15 U.S.C. §78s(b), proposed modifications to its existing options rules so as to provide for the trading on CBOE of options to purchase and sell GNMA securities. In response to its invitation for public comments, the SEC received 85 comment letters, including comments from a number of interested Government agencies—the Government National Mortgage Association, the Department of Housing and Urban Development, the Department of the Treasury, the Federal Reserve Bank of New York, the Board of Governors of the Federal Reserve System ("FRB") and the Commodity Futures Trading Commission ("CFTC"). The comments were generally supportive of CBOE's proposal and urged its prompt approval. They observed that CBOE's proposed GNMA options market would serve needs that were not currently filled by CBT's GNMA futures market and that it would greatly enhance the regulatory environment for trading of GNMA options and would be

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[4] Because GNMA securities are guaranteed by a Government corporation, they are also "exempted securities" as defined in Section 3(a)(12) of the Exchange Act, 15 U.S.C. §78c(a)(12). Although certain provisions of the Exchange Act do not apply to exempted securities, other provisions—including those which authorize the SEC to regulate national securities exchanges—apply to *any* securities, whether or not they are exempted securities. *See Superintendent of Insurance* v. *Bankers Life & Casualty Co.*, 404 U.S. 6, 10 & n.6 (1971).

[5] The word "commodity" is defined in the CEA as including "all services, rights, and interests in which contracts for future delivery are presently or in the future dealt in." Section 2(a)(1) of the CEA, 7 U.S.C. §2. A futures contract is a legally binding commitment to deliver or to receive a specified quantity and grade of a commodity during a designated month at a price that is determined in a transaction effected on a commodity board of trade.

likely to cure abuses that had been found in the existing market. The only negative comments were submitted by CBT, which argued that the CFTC had been granted exclusive or concurrent jurisdiction under the CEA to regulate options to purchase and sell securities such as GNMAs which had become "commodities" under the CEA.

On February 26, 1981, the SEC entered an order approving CBOE's proposed rules, finding them to be "consistent with the requirements of the [Exchange] Act and the rules and regulations thereunder and, in particular, the requirements of Section 6." (App. C-15).

On February 20, 1981, OCC filed with the SEC, pursuant to Section 19(b) of the Exchange Act, proposed rules that would provide for the issuance and clearance of GNMA options in the same general way that OCC's existing rules provided for the issuance and clearance of stock options. CBT again submitted comments questioning the SEC's jurisdiction. On August 6, 1981, the SEC entered an order approving OCC's rules, finding them to be "consistent with the requirements of the [Exchange] Act and the rules and regulations thereunder applicable to registered clearing agencies, and, in particular, the requirements of Section 17A." (App. D-12). OCC also filed with the SEC pursuant to the Securities Act of 1933 a supplement covering GNMA options as part of its current options prospectus, and the prospectus (including the GNMA options supplement) was declared effective by the SEC on October 30, 1981.

Pursuant to Section 25(a) of the Exchange Act, 15 U.S.C. §78y(a), CBT filed petitions to review the SEC orders which had approved the proposed rules of CBOE (No. 81-1660) and OCC (No. 81-2587).[6]

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[6] A third related case was instituted in the Court of Appeals for the Seventh Circuit by CBT and the Chicago Mercantile Exchange to review an SEC order which had approved rules of CBOE and the American Stock Exchange proposing trading on those exchanges of options on securities issued by the United States Department of the Treasury. The case (No. 82-1097) is awaiting further action by the Court of Appeals.

After No. 81-1660 had been fully briefed and argued, the SEC and the CFTC reached an agreement as to the scope of their respective jurisdictions. The agreement recognized "the SEC as the sole federal regulator of the securities options markets," including options on exempted securities such as GNMAs, and the CFTC as having no authority to regulate such options. Although the agencies agreed to the immediate implementation of the agreement, legislation was introduced in both houses of Congress to codify the agreement. This legislation has been favorably reported by the appropriate Congressional committees.[7]

Decisions Of The Court Below

On March 24, 1982, a sharply divided panel of the Court of Appeals rendered the opinions now sought to be reviewed. The majority in No. 81-1660 (consisting of Chief Judge Cummings and Senior District Judge Campbell) focused initially on the interplay between two jurisdictional provisions of Section 2(a)(1) of the CEA, 7 U.S.C. §2, that were added by the 1974 amendments to the CEA.[8] One of these provisions (the so-called "exclusive jurisdiction clause") granted the CFTC "exclusive jurisdiction with respect to accounts, agreements (including ... an 'option' ...), and transactions involving contracts of sale of a commodity for future delivery ...." The other (the so-called "SEC savings clause") preserved all jurisdiction of the SEC except to the extent of the jurisdiction granted to the CFTC in the exclusive

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[7] *See* H.R. Rep. No. 626, 97th Cong., 2d Sess. Part 1 at 6-9 (House Committee on Energy and Commerce) and Part 2 at 4-5 (House Committee on Agriculture) (1982); H.R. Rep. No. 565, 97th Cong., 2d Sess. Part 1 at 38-40 (House Committee on Agriculture) and Part 2 at 17 (House Committee on Energy and Commerce) (1982); S. Rep. No. 390, 97th Cong., 2d Sess. 5 (1982) (Senate Committee on Banking, Housing, and Urban Affairs); S. Rep. No. 384, 97th Cong., 2d Sess. 20 (1982) (Senate Committee on Agriculture, Nutrition, and Forestry).

[8] Commodity Futures Trading Commission Act of 1974, Pub. L. No. 93-463, 88 Stat. 1389.

jurisdiction clause. Reading these two provisions together, the Court of Appeals majority held that the CFTC had exclusive jurisdiction, and the SEC no jurisdiction, to regulate options on GNMA securities. It read the word "involving" in the exclusive jurisdiction clause as broadly meaning "relating to" any futures contract for a commodity (including a commodity that was also a security) (App. A-17–A-21), and it noted that GNMA options and the GNMA futures contracts traded on CBT are both "claimed to serve more or less the same purposes, and the prices in each market *assumedly* would affect one another" in determining that the options "involved" the futures. (App. A-29–A-32; emphasis added).

The majority also held that another provision of Section 2(a)(1) of the CEA (the so-called "Treasury amendment"), which explicitly provides that the CEA is not to be applicable to transactions in "security rights," "government securities" and "mortgage purchase commitments," does not apply to transactions in GNMA options. (App. A-34–A-36).

The majority further held that options to purchase and sell securities are not themselves securities under the federal securities laws and that the SEC has no jurisdiction under those laws to regulate the trading on national securities exchanges of options on exempted securities such as GNMAs. (App. A-37–A-49). On the basis of these holdings, the Court of Appeals set aside the SEC order that had approved CBOE's GNMA options rules. (App. A-50).

The dissenting opinion of Circuit Judge Cudahy took sharp issue with the holdings and reasoning of the majority, stating that the majority opinion

> fails at almost every turn to meet the tests of plain language, congressional intent, historical context and practical result. The opinion throws into disarray the agreement just reached between the CFTC and the SEC which would allow GNMA options trading to go forward forthwith on the CBOE. By reaching the extreme conclu-

> sion that the Securities Exchange Commission is without power under its own statutes to regulate options trading in what is incontestably a "security" —GNMA's—, the majority seems to have returned all parties to "square one" in this unseemly regulatory debacle.

(App. A-66). Specifically, the dissent concluded that the exclusive jurisdiction clause in the CEA applies only to options to purchase or sell futures contracts and not to options to purchase or sell securities (App. A-66–A-85), that GNMA options are excluded from the reach of the CEA by the "plain language" of the Treasury amendment (App. A-85–A-88), and that options to purchase or sell securities are themselves securities under the federal securities laws and are plainly subject to the SEC's regulatory jurisdiction (App. A-89–A-95).

On March 24, 1982, the Court of Appeals also entered its order in No. 81-2587. (App. B-1). The same majority found that there were no significant differences between the two cases. It held that the CFTC has exclusive jurisdiction under the CEA with respect to GNMA options and that the SEC has no jurisdiction under the securities laws to regulate the issuance and clearance by a registered clearing agency of options on exempted securities. Accordingly, it set aside the SEC's order approving OCC's rules on the basis of its opinion in No. 81-1660. Judge Cudahy dissented for the reasons set forth in his dissenting opinion in No. 81-1660.

REASONS FOR GRANTING THE WRIT

I.

IT IS IMPORTANT THAT THIS COURT DETERMINE WHICH OF TWO DIFFERENT FEDERAL REGULATORY SCHEMES APPLIES TO NEW TYPES OF SECURITIES OPTIONS.

This case presents, as a matter of first impression, a fundamental jurisdictional question under two different statutory schemes (the federal securities laws and the CEA)

that is of vital importance to the development and regulation of the trading markets for a growing number of new types of securities options. The resolution of this question not only will determine which federal agency has regulatory authority over these options, but it will also determine the type of market in which they may be traded under existing federal law, the manner in which professional participants in those markets are regulated, and the nature and extent of the statutory protections that have been extended by Congress to public investors.

During the past ten years, new types of securities options designed to reduce investors' economic risks and to increase their investment flexibility have been developed by national securities exchanges. These options, which were first introduced in 1973 when trading began on CBOE in options to purchase 16 underlying stocks, have grown enormously in public acceptance and in their importance to the securities industry. There are now four national securities exchanges on which options on more than 360 stocks are traded. During 1981, transactions in over 100 million option contracts (representing the right to purchase or sell more than 10 billion shares of stock) were effected on these four exchanges at an aggregate price in excess of $40 billion. CBOE and other national securities exchanges also have filed proposals with the SEC to provide for exchange trading of options on a number of other securities—not only the options on GNMA securities that are the subject of this case, but also options on securities issued by the Department of the Treasury, on groups of common stocks and on indices of common stock prices.[9]

During this same ten-year period, commodity boards of trade, which had formerly traded only contracts of sale for future delivery of agricultural commodities and metals, have begun to trade futures contracts on various financial instru-

[9] All of these proposed options are to be issued by OCC and sold in the same manner as OCC stock options have been issued and sold since 1973.

ments, including GNMA securities, certain Treasury securities and certain stock indices. They also have proposals pending with the CFTC to trade futures contracts on prices of common stock groups and on AT&T corporate bonds.

The development by the commodity boards of trade of these new futures contracts on securities has blurred the line between commodities and securities and has thereby presented questions as to which federal statutory scheme is applicable to—and which federal agency (the SEC or the CFTC) has been vested with jurisdiction to regulate—the trading of options to purchase or sell a security that becomes a "commodity" under the CEA. Since the word "commodity" is now defined in the CEA to include "all services, rights, and interests in which contracts for future delivery are presently or in the future dealt in," when an instrument which is indisputably a "security" under the federal securities laws—e.g., a GNMA security, a Treasury bond or an AT&T corporate bond—becomes the subject of a futures contract traded on a board of trade, then that security also literally becomes a "commodity" under the CEA.

Whether options on these securities are subject to regulation by the SEC or CFTC is not simply a "turf" battle between two federal agencies. Rather, the resolution of this question will determine which of two distinct sets of regulatory protections is available to public investors. For example, if securities options are securities subject to regulation under the securities laws, then public investors are entitled to the benefit of a number of regulatory safeguards: the regulation of public offerings and sales under the Securities Act of 1933, the margin regulations of the FRB,[10] the regulatory protec-

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[10] *See* Section 7 of the Exchange Act, 15 U.S.C. §78g, and Section 3(i) of FRB Regulation T, 12 C.F.R. §220.3(i). In contrast, the CFTC has no authority to set levels of margin for commodity futures contracts under Section 5a(12) of the CEA, 7 U.S.C. §7a(12).

tions of the state securities laws,[11] the established pervasive scheme for regulation of securities options sales practices that has been imposed by the SEC on the national securities exchanges and broker-dealers,[12] and the insurance protections afforded by the Securities Investor Protection Act of 1970, as amended, 15 U.S.C. §§78aaa-78*lll*, in the event of a securities broker's insolvency. If, however, the transformation of the securities underlying these options into a "commodity" causes the options to become subject to the exclusive jurisdiction of the CFTC under the CEA, then these safeguards are not available to public investors. We do not believe Congress ever intended these profound results. Thus, this Court's determination as to the choice of regulatory scheme intended by Congress is a matter of great importance to public investors in securities options.

Moreover, the uncertainty as to which regulatory scheme is applicable has left securities exchanges in a quandary. An exchange that wishes to become a market for the trading of options on an instrument that is both a security and a commodity cannot be sure with which federal agency it should file for approval, and the agencies themselves do not know whether they should process the filings.[13] This jurisdictional confusion has thus continued to delay the introduction

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[11] Section 28(a) of the Exchange Act, 15 U.S.C. §78bb(a), expressly preserves the jurisdiction of state securities laws insofar as they do not conflict with the provisions of the Exchange Act. In contrast, state regulatory laws are totally preempted with respect to matters that are within the exclusive jurisdiction granted to the CFTC under Section 2(a)(1) of the CEA, 7 U.S.C. §2.

[12] *See, e.g.*, Sec. Ex. Act Rel. No. 15575, 44 Fed. Reg. 11876 (1979) (requiring securities options exchanges to adopt new sales practice rules before any new options listings would be permitted); Sec. Ex. Act Rel. No. 16696, 45 Fed. Reg. 21420 (1980) (approving the new rules).

[13] Under the decision of the Court of Appeals, even the mutual agreement of the agencies would not assure an exchange that it has chosen the right agency. (App. A-9 n.8; A-65; A-98).

of new securities options that would serve important economic purposes.

The unfilled need for exchange-traded GNMA options illustrates the problem. Although the record before the SEC in this case establishes that GNMA options are urgently needed by mortgage bankers in order to enhance their ability to finance residential construction, trading in GNMA options has been thwarted by the jurisdictional questions presented by this litigation. Similarly, the pending proposals of national securities exchanges for options on Treasury securities and on stock indices are in limbo as a result of the jurisdictional uncertainties. And, even if one agency should approve a particular proposal, until the questions presented by this case are settled by this Court, no exchange, no clearing agency, and no broker-dealer can be confident that its actions in accordance with one federal statutory scheme will not be held to be in violation of the other.

Unfortunately, the decisions of the Court of Appeals have created more jurisdictional uncertainties than they have resolved. As noted in Part II below, the Court of Appeals' erroneous holding that securities options are not securities casts doubt upon, and severely disrupts, the existing basis for regulation of the securities options markets. It results in a limitation of the powers which have long been exercised by the SEC and the FRB to regulate transactions in securities options, and it creates a gap in the regulation of options on exempted securities. And, as noted in Part III below, the Court of Appeals holding creates uncertainty as to whether the CEA or the Exchange Act applies to options on any security (other than GNMAs) which becomes a "commodity." If the Court of Appeals opinions are left to stand, the fundamental jurisdictional questions presented in these cases will have to be relitigated on an *ad hoc* basis in respect of options on virtually every other security which is, or which may become, the subject of futures trading in order to determine which statutory scheme applies.

II.

THE COURT OF APPEALS HOLDING THAT OPTIONS ARE NOT SECURITIES WILL SEVERELY DISRUPT THE ESTABLISHED REGULATORY SCHEME PERTAINING TO SECURITIES OPTIONS, IS INCONSISTENT WITH THE HOLDINGS OF THIS COURT AND OTHER COURTS AND WILL CREATE A SUBSTANTIAL REGULATORY GAP.

The Court of Appeals majority held that securities options are not themselves securities within the meaning of the securities laws and that the SEC therefore lacks jurisdiction under the securities laws to regulate options on exempted securities.[14] (App. A-37–A-49). If allowed to stand, this holding would seriously disrupt the established regulatory scheme pertaining to options on all securities, including the stock options that are currently traded on four national securities exchanges, whether or not such securities now are or ever become commodities.

Options of the type traded on CBOE and issued by OCC have, from their inception, been regarded by investors, professionals and regulators to be securities. They have been widely offered and sold as securities to the general public through prospectuses; they have been traded as securities on national securities exchanges; they are instruments having equivalent values in which there is common trading; their prices are widely reported by securities information processors; orders for their purchase and sale are transmitted through securities broker-dealers and executed in the same fashion as for other securities; and they are standardized, transferable and hypothecatable instruments.

Securities options have, moreover, long and consistently been treated as securities by the responsible federal agen-

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[14] The majority held that the SEC's authority to regulate options stems solely from Section 9 of the Exchange Act, 15 U.S.C. §78i (which, it held, does not apply to options on exempted securities). (App. A-46–A-48).

cies. Since 1973 they have been registered as securities under the provisions of the Securities Act of 1933 and the Exchange Act; they have been included within the SEC's definition of "equity securities" in SEC Rule 3a11-1, 17 C.F.R. §240.3a11-1; they are subject to the transaction reporting rules of the SEC;[15] options specialists are subject to regulation under Section 11(b) of the Exchange Act, 15 U.S.C. §78k(b);[16] and options have been treated as securities by the FRB for purposes of setting margin requirements under Regulation T, 12 C.F.R. §220.3(i). In short, a securities option issued by OCC and traded on national securities exchanges is clearly an instrument "commonly known as a 'security'" and therefore falls within the statutory definition of "security." Section 3(a)(10) of the Exchange Act, 15 U.S.C. §78c(a)(10).

The Court of Appeals holding thus ignores the repeated teachings of this Court that the definition of security in the securities laws was meant to include "the many types of instruments that in our commercial world fall within the ordinary concept of a security" and that the test of a security "is what character the instrument is given in commerce by the terms of the offer, the plan of distribution, and the economic inducements held out to the prospect." *Marine Bank v. Weaver*, U.S. , 102 S.Ct. 1220, 1223 (1982). *Accord, Tcherepnin v. Knight*, 389 U.S. 332, 338 n.19 (1967); *SEC v. United Benefit Life Insurance Co.*, 387 U.S. 202, 211 (1967); *SEC v. W. J. Howey Co.*, 328 U.S. 293, 299 (1946); *SEC v. C. M. Joiner Leasing Corp.*, 320 U.S. 344, 352-53 (1943). In prior decisions in which this Court has found instruments to be securities under the securities laws, it has attached considerable weight to the fact that the instruments were offered to a number of potential investors, that there had been "common trading" in the instruments, that the instruments "had equivalent values to most persons and could have

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[15] *See* Sec. Ex. Act Rel. No. 17638 (March 18, 1981), 22 SEC Docket 484, *reprinted in* [1981 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶82,850.

[16] *See* Sec. Ex. Act Rel. No. 17574, 46 Fed. Reg. 15134 (1981).

been traded publicly," and that the instruments had been publicly offered to potential investors through a prospectus. *Marine Bank v. Weaver*, 102 S.Ct. at 1225. Although all of these factors apply to securities options issued by OCC, the majority below considered none of them. The odd result is that an instrument which has been uniformly deemed to be a security by those responsible for it—its issuer, the broker-dealers who sell it, the exchanges where it is traded, the SEC and the FRB—is held not to be a security upon the petition of a person (the CBT) which is essentially a stranger to transactions in options.[17]

The holding below also conflicts with the Sixth Circuit's decision in *Mansbach v. Prescott, Ball & Turben*, 598 F.2d 1017 (6th Cir. 1979), which expressly held that the definition of "security" in Section 3(a)(10) of the Exchange Act, 15 U.S.C. §78c(a)(10), includes exchange-traded options to purchase or sell stock. *Id.* at 1026 n.40. Further, it is in conflict with the holdings of most district courts which have decided this issue,[18] with recent statements by the Congressional committees having oversight over the administration of the

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[17] In its comments to the SEC with respect to CBOE's proposed rules, CBT assumed that (absent the provisions of the CEA) the SEC had jurisdiction under the securities laws. It was not until it filed comments with respect to OCC's rules that CBT first argued that the SEC did not have jurisdiction under the securities laws over options on exempted securities.

[18] *See, e.g., In Re McDonnell Douglas Corp. Securities Litigation*, [Current Binder] Fed. Sec. L. Rep. (CCH) ¶98,737 at 93,723 (E.D. Mo. June 22, 1982); *Savino v. E.F. Hutton & Co.*, 507 F. Supp. 1225, 1235 (S.D.N.Y. 1981); *Lloyd v. Industrial Bio-Test Laboratories, Inc.*, 454 F. Supp. 807, 811 (S.D.N.Y. 1978); *Vogel-Lorber, Inc. v. Options on Shares Inc.*, [1974-1975 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶94,911 at 97,109 (S.D.N.Y. 1974). In contrast, the only cases involving options on securities cited in the decision below are inapposite because the options in those cases were privately negotiated agreements rather than publicly traded instruments. *See LTV Federal Credit Union v. UMIC Government Securities, Inc.*, 523 F. Supp. 819 (N.D.Tex. 1981); *Miller v. General Outdoor Advertising Co.*, 223 F. Supp. 790 (S.D.N.Y. 1963), *rev'd. on other grounds*, 337 F.2d 944 (2d Cir. 1964).

federal securities laws[19] and with the leading securities law treatise.[20]

The holding that options are not securities does not, of course, strip the SEC of all regulatory authority over options on non-exempted securities. *See* Sections 9(b) and 9(c) of the Exchange Act, 15 U.S.C. §78i(b)-(c). Nevertheless, if options are not themselves securities, a number of important statutory provisions—including the entire Securities Act of 1933, the margin regulations of the FRB, the regulation of OCC as a registered clearing agency and of CBOE as a national securities exchange, and the regulation of broker-dealers who deal solely in options—will either not apply at all or will be severely limited in their application.

Finally, if securities options are held not to be securities, a regulatory gap will exist with respect to options on

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[19] In its report recommending enactment of legislation to implement the SEC-CFTC jurisdictional agreement, the House Committee on Energy and Commerce stated:

> Although the word "option" is not explicitly included in the definition of "security," a call option on a security is a "right to purchase" a security and both put and call options [on] securities are considered instruments "commonly known as" securities.

H.R. Rep. No. 626, 97th Cong., 2d Sess. Part 1 at 3 (1982). The House Committee also stated its belief that the decision by the Court of Appeals below "is not consistent with long-standing Congressional intent that the SEC has the sole authority to regulate options on all securities, including exempted securities. *Id.* at 8. The Report of the Senate Committee on Banking, Housing, and Urban Affairs similarly stated that the "comprehensive authority [of the SEC] to regulate securities extends to put and call options on securities" and that options "currently are considered to be within the definitions of 'security' " in the federal securities laws. S. Rep. No. 390, 97th Cong., 2d Sess. 3, 5 (1982).

[20] *See* 1 L. Loss, *Securities Regulation* 469 (2d ed. 1961) ("A call is a 'right to . . . purchase' a security within the literal language of the definition; but a put is a right to *sell*. At the same time, both types of option are such an integral part of securities trading that it seems entirely reasonable to subsume them under the phrases 'investment contract' and 'interest or instrument commonly known as a "security." ' " (Emphasis in original)).

exempted securities. Only a limited number of exempted securities—GNMAs and certain Treasury securities—are "commodities" under the CEA and, even under the Court of Appeals holding, the CFTC would have no jurisdiction to regulate options on any other security. The holding below thus creates a startling regulatory gap—neither the SEC nor the CFTC would have jurisdiction to regulate transactions in options on any other exempted security, and such options would totally escape federal regulation.

III.

INSTEAD OF DRAWING THE CLEAR AND SIMPLE JURISDICTIONAL LINE INTENDED BY CONGRESS, THE COURT OF APPEALS HOLDING FASHIONS AN AMBIGUOUS AND UNCERTAIN JURISDICTIONAL TEST THAT NEEDLESSLY REQUIRES AN AD HOC DETERMINATION OF JURISDICTION IN VIRTUALLY EVERY FUTURE CASE.

As noted above, the CEA grants the CFTC exclusive jurisdiction "with respect to accounts, agreements (including . . . an 'option' . . .), and transactions *involving contracts of sale of a commodity for future delivery.*" (Emphasis added). It also provides that, except for such exclusive jurisdiction of the CFTC, the SEC's jurisdiction is not to be limited or superseded by the CEA. As a result, the critical question presented to the Court of Appeals was whether the language italicized above should be interpreted to make the exclusive jurisdiction clause apply only to options to purchase or sell a futures contract or whether it should be interpreted to sweep within the clause any option having any relationship to a futures contract.

The narrower interpretation—that "involving" was intended, in the case of options, to pertain only to options to

purchase and sell a futures contract[21]—draws a clear and definitive jurisdictional line which can be readily applied and understood in all cases. That interpretation is consistent with the line drawn by the two agencies in their jurisdictional agreement. (*See* p. 6, *supra*). It is also consistent with the CFTC's own use of the words "involving contracts for future delivery"[22] and the analysis by the CFTC's present Chairman and by other leading commentators.[23]

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[21] The antecedent of "involving" in Section 2(a)(1) is "accounts, agreements (including . . . an 'option' . . .), and transactions." Given those words, Congress obviously had to use a word such as "involving" which, by its very breadth, would sensibly fit all of them in relation to the following phrase: "contracts of sale of a commodity for future delivery." But it does not follow that Congress meant to sweep into the CFTC's exclusive jurisdiction every option having any relationship to a futures contract. With respect to options, a narrow reading of "involving" is the most natural: an option obviously "involves" whatever is the underlying security or product that is subject to the option—in this case, a futures contract.

[22] In the announcement of its new regulations governing options on futures contracts, the CFTC stated:

> The Commission [CFTC] stated in its proposal that it believed that "priority should be given to adopting and implementing regulations which will permit trading of commodity options *involving contracts for future delivery.*" 46 FR at 33294. The proposed rules therefore did not specifically provide for the exchange trading of *options on actual commodities* . . . .

46 Fed. Reg. 54500, 54501 (1981) (emphasis added). This statement makes clear that the CFTC regards the phrase "involving contracts for future delivery" as including only options on futures.

[23] Philip Johnson, then outside counsel to CBT and now Chairman of the CFTC, analyzed the scope of the CFTC's exclusive jurisdiction over options as follows:

> The CFTC's exclusive jurisdiction, however, did not extend to *securities* options such as those traded on the Chicago Board Options Exchange or the American Stock Exchange, since such options, when exercised, do not result in the delivery of a futures contract.

Johnson, *The Commodity Futures Trading Commission Act: Preemption As Public Policy*, 29 Vand. L. Rev. 1, 15 n.45 (1976) (emphasis in original). As the dissenting opinion below notes, other commentators have consistently construed the exclusive jurisdiction clause to reach options on futures, but not options on the underlying instruments. *See* App. A-68–A-69 and the materials there cited.

More importantly, it is consistent with the repeated expressions by Congress that it did not intend to vest the CFTC with authority over securities options. Thus, the Senate Agriculture and Forestry Committee Report stated that the CFTC

> would not have the authority to regulate trading in puts and calls for securities. Where traded on exchanges, these puts and calls are regulated by the Securities and Exchange Commission.

S. Rep. No. 1131, 93d Cong., 2d Sess. 26 (1974), *reprinted in* 1974 U.S. Code Cong. & Ad. News 5843, 5866. To make the point even more explicit, the Senate Report also stated that the CFTC "will have exclusive jurisdiction over options trading in commodities (*but not in securities*)." *Id.* at 31, *reprinted in* 1974 U.S. Code Cong. & Ad. News at 5870 (emphasis added). These statements and other similar statements from the legislative history compiled in the dissenting opinion below (App. A-80–A-83) show that Congress intended to draw a clear and simple jurisdictional line, with options on futures contracts subject to the jurisdiction of the CFTC and options on securities subject to the jurisdiction of the SEC.

The Court of Appeals majority rejected these authorities and adopted a broad interpretation of the CFTC's exclusive jurisdiction based entirely on its expansive reading of the word "involving" as meaning something like "having an economic relationship to." (App. A-17–A-21; A-28–A-32).[24] The basis on which the majority below reached this conclusion is obscure. Nothing in the statute or in the materials cited by the majority requires that result. Thus, it cited the fact that the words "relating to" had appeared in an earlier draft of the bill (App. A-19–A-20), even though those words were later dropped from the final version of the law and the draft bill that did contain these words also contained a provision expressly reserving *all* of the SEC's jurisdiction without

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[24] The dissent aptly observed that the "majority's almost total reliance on the word 'involving' in the exclusive jurisdiction clause to bear the crushing burden of options on actuals is to rest the Rock of Gibraltar on a toothpick." (App. A-69).

regard to the "exclusive jurisdiction" vested in the CFTC;[25] it cited a law review article as authority for its interpretation of the word "involving" (App. A-19), but it rejected a direct statement appearing in that same law review article that concluded that the exclusive jurisdiction clause did not apply to options on securities (App. A-19 n.18);[26] and it relied on a statement in a Senate Report suggesting that the CFTC was to have exclusive jurisdiction over "commodity options" (App. A-20), but it ignored its own statement that the term "commodity options" was used ambiguously in the legislative history to mean either options on futures or options on the underlying instruments (App. A-21), and it rejected other statements appearing in the same Senate Report explicitly indicating Congress' intention that the CFTC was not to have authority to regulate options on securities (App. A-22–A-24).[27] Nevertheless, relying on these three citations, the majority concluded that the CFTC's exclusive jurisdiction extended to options on securities.

Since any security could become a "commodity" under the majority's literal reading of the CEA (App. A-10), this overly broad interpretation of the majority could potentially sweep *all* securities options into the CFTC's exclusive jurisdiction. Even the majority recognized that there must be some limits (App. A-21–A-29), since the Congressional sponsors of the 1974 amendments to the CEA had expressly stated that the "limited" grant of exclusive jurisdiction to the CFTC

> was not intended, however, to apply to trading in interests and rights traditionally known as securities, including, for example, stocks, corporate bonds, warrants, and debentures, nor was it intended to apply to trading in options to purchase any of the foregoing.

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[25] H.R. Rep. No. 975, 93d Cong., 2d Sess. 87 (1974).

[26] *See* Johnson, *The Commodity Futures Trading Commission Act: Preemption As Public Policy*, 29 Vand L. Rev. 1, 15 n.45, quoted *supra* at n.22. Also *see* App. A-68 n.4.

[27] These are the statements appearing at p. 19, *supra*.

120 Cong. Rec. 34737 (1974) (explanatory statement of House Agriculture Committee Chairman Poage); 120 Cong. Rec. 34997 (1974) (identical statement of Senate Agriculture and Forestry Committee Chairman Talmadge). This led the majority to suggest that the grant of exclusive jurisdiction might not apply in cases involving options on "traditional" securities or on securities that are not "legitimate" commodities although neither term appears in the statute, but it put this question off to the future. (App. A-27–A-29).

As a result, the Court of Appeals majority holding gives no guidance as to whether options on any security other than GNMAs are within the CFTC's exclusive jurisdiction. For example, although certain securities issued by the Department of the Treasury are now commodities under the CEA, it would seem clear, under any conceivable standard, that Treasury securities are "traditional" securities, since they have been in existence almost as long as this nation and were among the first securities to be traded on this nation's securities exchanges. Similarly, AT&T corporate bonds would clearly seem to be "traditional," but the holding below leaves open whether jurisdiction over options on such bonds would flow from the SEC to the CFTC if and when they became the subject of futures contracts.[28] These uncertainties are compounded by the fact that, under the majority decision, the application of the "involving" test in the exclusive jurisdiction clause is to be based on factual determinations (App. A-27–A-32), which will necessarily differ from security to security. Thus, instead of fixing a simple and clear jurisdictional line, the holding below fashions a test that will lead to needless and continuing litigation to determine jurisdiction for options on every security that is or becomes a commodity.

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[28] Compare, for example, the suggestion in footnote 2 of the majority opinion in No. 81-1660 that even futures contracts in stocks and stock options might be traded on the CBT under the CEA (App. A-6 n.2) with the majority's suggested limitation with respect to options on "traditional" securities (App. A-27).

Even in those situations in which it may be clear at a given time that options on a particular security are subject to regulation under the securities laws, that regulatory scheme would be subject to being displaced under the holding below if, as a result of action by a commodity board of trade, that security were to become subject to futures trading. For example, CBOE's stock options have long been subject to SEC jurisdiction, but, subject to the vagaries inherent in the majority's use of the words "traditional" and "legitimate," the SEC's jurisdiction might be immediately displaced if trading in futures contracts on underlying stocks were permitted to commence or if the stock options should otherwise be held to "involve" futures contracts. This constant threat of regulatory disruption—whereby conduct that is legal and properly regulated under one federal statute at one moment could become illegal and regulated under a different statutory scheme at the next moment—creates intolerable uncertainty for the public, the securities industry and the courts.

CONCLUSION

The Court of Appeals has erroneously decided important questions of federal law which should be reviewed and settled by this Court. Petitioners respectfully request that a writ of certiorari issue to review the judgments of the Court of Appeals for the Seventh Circuit.

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No. 82-327

In the Supreme Court of the United States

OCTOBER TERM, 1982

CHICAGO BOARD OPTIONS EXCHANGE, INCORPORATED

and

THE OPTIONS CLEARING CORPORATION,
Petitioners,

v.

BOARD OF TRADE OF THE CITY OF CHICAGO,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

MEMORANDUM OF THE CHICAGO BOARD OPTIONS EXCHANGE, INCORPORATED AND THE OPTIONS CLEARING CORPORATION SUGGESTING MOOTNESS

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MEMORANDUM OF THE CHICAGO BOARD OPTIONS EXCHANGE, INCORPORATED AND THE OPTIONS CLEARING CORPORATION SUGGESTING MOOTNESS

The decisions below of the United States Court of Appeals for the Seventh Circuit set aside orders of the Securities and Exchange Commission ("SEC") that had approved the rules of the Chicago Board Options Exchange, Incorporated ("CBOE") for trading options on securities guaranteed by the Government National Mortgage Association ("GNMA options") and rules of The Options Clearing Corporation ("OCC") for the issuance, clearance and settlement of GNMA options. (Pet. App. A-1 to A-99 and B-1 to B-5).[1] The decisions

[1] "Pet. App." refers to the appendix to the petition for a writ of certiorari filed herein by CBOE and OCC on August 25, 1982. Another petition for a writ of certiorari (No. 82-526) has been filed by the Solicitor General on behalf of the SEC to seek review of the judgments in these cases. Pursuant to Rule 28.1 of the Rules of this Court, CBOE and OCC state that they have no parent companies, subsidiaries (other than wholly owned subsidiaries) or affiliates.

below held that (1) the issuance and trading of GNMA options were subject to the exclusive regulatory jurisdiction of the Commodity Futures Trading Commission ("CFTC") under the provisions of Section 2(a)(1) of the Commodity Exchange Act ("CEA"), 7 U.S.C. § 2, and were therefore subject to the commodity option ban set forth in Section 4c(c) of the CEA, 7 U.S.C. § 6c(c), (Pet. App. A-11 to A-36), and (2) the SEC had no authority under the Securities Exchange Act of 1934 (the "Exchange Act"), 15 U.S.C. §§ 78a-78kk, to approve CBOE's and OCC's proposed rules because GNMA options were not "securities" (as then defined in the Exchange Act) and because the SEC's authority to regulate securities options under Section 9 of the Exchange Act, 15 U.S.C. § 78i, did not apply to options on exempted securities (Pet. App. A-37 to A-48).

These cases are now moot for two reasons. First, on October 13, 1982, the President signed a bill (Pub. L. No. 97-303, 96 Stat. 1409)[2] that effectively overrules the decisions of the Court of Appeals. *See Kremens v. Bartley*, 431 U.S. 119, 128-29 (1977) (enactment of new statute mooted claims based on prior law). Under the new legislation, the definition of "security" in Section 3(a)(10) of the Exchange Act, 15 U.S.C. § 78c(a)(10), has been amended to include explicitly "any put, call, straddle, option, or privilege on any security." In addition, Section 9(f) of the Exchange Act has been amended to make the exclusion of exempted securities contained therein apply only to subsection 9(a) and not to those provisions of Section 9 which provide for SEC regulation of options transactions effected on a national securities exchange. Finally, a new Section 9(g) has been added to the Exchange Act which states in pertinent part:

> Notwithstanding any other provision of law, the Commission [SEC] shall have the authority to regulate the trading of any put, call, straddle, option, or privilege on any security . . . .

This legislation makes it clear that the SEC, and not the CFTC or any other federal agency, has the authority to regulate

[2] The text of Pub. L. No. 97-303 is reprinted in the appendix to the Memorandum for the Securities and Exchange Commission Suggesting Mootness filed by the Solicitor General in No. 82-526 on October 18, 1982.

options on all securities, including options on GNMA securities.

Second, CBOE and OCC refiled with the SEC their respective rules relating to GNMA options, and on October 14, 1982, the SEC issued a new order approving these rules under its authority as clarified by Pub. L. No. 97-303. Securities Exchange Act Release No. 19125, 47 Fed. Reg. 46,934 (1982). On October 15, 1982, the Board of Trade of the City of Chicago ("Board of Trade"), the respondent herein, filed in the United States Court of Appeals for the Seventh Circuit a petition to review this new SEC order.[3] In these circumstances, the validity of the SEC's previous orders under the law as it existed in 1981 has become an academic question that cannot affect the rights of the litigants. *See DeFunis v. Odegaard*, 416 U.S. 312, 316 (1974).

CBOE and OCC therefore respectfully submit that the petition for a writ of certiorari should be granted, the judgments of the Court of Appeals vacated, and the cases remanded with directions to dismiss the petitions for review as moot. *United States v. Munsingwear, Inc.*, 340 U.S. 36, 39-40 (1950).[4]

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[3] The Board of Trade also filed with the Court of Appeals a motion for an emergency stay, which was denied by an order dated October 21, 1982. On October 21, 1982, the Board of Trade filed an emergency motion for reconsideration *en banc* of the stay motion, and on the same day the Court of Appeals (*en banc*) denied the motion "because [Pub. L. No. 97-303] grants the [SEC] jurisdiction under the securities laws to authorize options on government securities."

[4] The memorandum filed by the Solicitor General in No. 82-526 requests the same disposition of these cases.

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No. 82-

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ALEXANDER L. STEVAS,

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Respondent.

APPENDIX TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT (SEVENTH CIRCUIT NOS. 81-1660, 81-2587)

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Rules and Regulations Under the Securities Exchange Act of 1934:

Rule 3a11-1, 17 C.F.R. §240.3a11-1 (1981) H-14

In the

United States Court of Appeals

For the Seventh Circuit

No. 81-1660

BOARD OF TRADE OF THE CITY OF CHICAGO,

Petitioner,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent,

and

CHICAGO BOARD OPTIONS EXCHANGE, INCORPORATED,

Intervenor-Respondent.

On Petition for Review of an Order of the Securities and Exchange Commission.

ARGUED NOVEMBER 4, 1981—DECIDED MARCH 24, 1982

Before CUMMINGS, *Chief Judge*, CUDAHY, *Circuit Judge*, and CAMPBELL, *Senior District Judge.**

CUMMINGS, *Chief Judge*. The issue in this case is whether the Securities and Exchange Commission (SEC) has authority to regulate trading in options on Government National Mortgage Association mortgage-backed pass-through certificates (GNMA's), given that GNMA's are both "commodities" and "securities." We

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* The Honorable William J. Campbell, Senior District Judge for the Northern District of Illinois, is sitting by designation.

hold that pending further action by the Commodity Futures Trading Commission (CFTC), all trading of options on GNMA's is prohibited and that the SEC has no jurisdiction of its own to permit trading in GNMA options.

I

Last April the Board of Trade of the City of Chicago (Board of Trade) petitioned us to set aside an order of the SEC approving rule changes of the Chicago Board Options Exchange, Incorporated (CBOE). The CBOE rule changes would have allowed trading on the CBOE of exchange-formed off-set options on GNMA's. The underlying instruments, GNMA's or Ginnie Maes, are the product of a program administered by the Government National Mortgage Association, a Government corporation within the Department of Housing and Urban Development. See 12 U.S.C. §§ 1716 *et seq.*; 24 C.F.R. ch. III. The program is designed to increase liquidity in the secondary mortgage market and attract new private sources of funds into residential loans. Under this program, GNMA certificates are issued by private institutions (primarily mortgage bankers) to represent interests in pools of Government-underwritten residential mortgages. The owner of a GNMA certificate receives a proportion of the income generated as mortgagors in the pool repay their loans, and the timely payment of principal and interest to the GNMA owner is guaranteed by the Government National Mortgage Association. GNMA's, like most securities or commodities, are fully transferable from one investor to another. As the CBOE has advised us, "Institutional investors of all types have been attracted to GNMA's because such investments have favorable yields, good liquidity and a high degree of safety" (Br. 5). Although the regular payments of principal and interest are guaranteed, they are fixed for the life of the pooled mortgages, and consequently GNMA owners bear the risk that mortgage interest rates may fluctuate, making the GNMA certificates more or less valuable. The two derivative instruments at issue here, GNMA options and GNMA futures, allow GNMA traders to transfer the risks associated with value fluctuations to speculators.

The CBOE's proposed market in GNMA options differs from the market in the underlying GNMA's in that when an option contract is traded no GNMA's change hands. The purchaser or "holder" of a GNMA option acquires only the right to buy or sell a specified quantity and quality of GNMA's at a specified price prior to a specified date. Conversely, in return for a premium, the seller or "writer" of the option (here, the CBOE's clearing house) undertakes the obligation of either selling or buying the GNMA's in the event that the holder "exercises" the purchased option. Under the CBOE's proposed rule changes, however, neither party need ever own or deliver any GNMA's in order to profit from the option transaction. The writer of the option may liquidate his position prior to the holder's exercise by purchasing an identical option, in effect transferring the obligation to a new option writer. Likewise, the option holder may recover the value of his option without actually exercising it simply by purchasing an equal but opposite option (an option to buy to match an option to sell, or vice versa). The original option and its opposite, "offsetting" option are then cancelled through the CBOE clearing house. Thus the CBOE's proposed options market could exist and prosper without any of the traders ever exercising the options and buying or selling the GNMA's.

The Board of Trade, a separate market from the CBOE, has since 1975 traded a different GNMA derivative—futures on GNMA's—pursuant to the designation of the other regulatory agency involved in this case, the CFTC. GNMA futures are obligations to make or take delivery of a specified quantity and quality of GNMA's at a particular time in the future and at an agreed price. Both parties to a futures contract are obligated to perform; there is no choice by either party to exercise a right to performance as there is with options. Nevertheless, investors may deal in GNMA futures without ever intending to deliver or take delivery of GNMA's because, like the proposed options, futures contracts may be offset by purchase or sale of an equal and opposite contract. Indeed, futures markets generally are not used to obtain actual delivery of a commodity. Most contracts are fulfilled by entering into

an offsetting contract, and fewer than 3% of all futures contracts are fulfilled by taking (or making) actual delivery of the underlying commodity. See *Commodity Futures Trading Commission Act of 1974: Hearings on H.R. 11955 Before the House Committee on Agriculture*, 93d Cong., 2d Sess. 238 (1974) (statement of Sen. R. Clark); G. Clark, *Genealogy and Genetics of "Contract of Sale of a Commodity For Future Delivery" in the Commodity Exchange Act*, 27 Emory L.J. 1175, 1176 (1978). The differences between options and futures may be quite technical, *see, e.g.*, Moriarty, Phillips & Tosini, *A Comparison of Options and Futures in the Management of Portfolio Risk*, Financial Analysts J. 61 (Jan./Feb. 1981), but a complete understanding of the differences has not been necessary to decide this case.[1]

Important for understanding the motivation behind this and related lawsuits, however, is the great similarity of functions served by the two GNMA derivatives and

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[1] Yet another GNMA derivative, options on GNMA futures, may soon be traded under new rules of the CFTC. See 46 Fed. Reg. 54500 (Nov. 3, 1981). The holder of an option on GNMA futures has the right, until a specified date, to buy from or sell to the option writer a futures contract in GNMA's. When the holder exercises such an option, he purchases (or sells) a futures "position" rather than the actual GNMA's. Although CFTC jurisdiction to permit trading in these instruments is undisputed and the SEC has not attempted to exercise jurisdiction with respect to them, options on commodity futures will be involved in arguments concerning statutory construction *infra*.

Options on the underlying commodity are sometimes distinguished from options on commodity futures by an adjective such as "actual," "physical" or "tangible" (*e.g.*, "option on actual commodity"), *see, e.g.*, 46 Fed. Reg. 54501; 120 Cong. Rec. 34737 (remarks of Rep. Poage), but we shall not adopt that convention. In this opinion, "commodity option" will mean an option on the underlying commodity and nothing else.

For a lucid introduction to commodity futures trading and its impact on commodity production and consumer prices, see Greenstone, *The CFTC and Government Reorganization: Preserving Regulatory Independence*, 33 Bus. Law. 163, 164-177 (1977).

the tremendous revenue they may generate for the exchanges on which they are traded. Both options and futures allow GNMA traders to shift to speculators the risk of changing mortgage interest rates, Moriarty, Phillips & Tosini, *supra*, and the volume of risk-shifting and speculation has been tremendous. In 1981, for example, there were approximately 2,293,000 sales of GNMA futures contracts on the Board of Trade, each contract representing $100,000 in unpaid mortgage principal. Thus when the CBOE proposed rule changes with the SEC to accommodate the creation of a market in exchange-formed off-set options on GNMA's, the Board of Trade filed comments criticizing the CBOE proposal.[2] The Board of Trade argued to the SEC that

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[2] Much of the division between futures and options trading has been fortuitous. In the beginning, both futures and options were regulated together under the Future Trading Act of 1921. The two were then cast asunder in 1922 by the Supreme Court decision of *Hill v. Wallace*, 259 U.S. 44, which by happenstance invalidated only the futures portion of the 1921 Act. Following reenactment of the futures regulation in the Grain Futures Act of 1922 and invalidation in 1926 of the 1921 options remnant by *Trusler v. Crooks*, 269 U.S. 475, futures and options regulations were rejoined within the Commodity Exchange Act of 1936. For some 30 years, futures and options led a happy life together; futures being perceived as the legitimate hedging and price-discovery vehicle and options as the farmer-feared device of reckless speculators. Then the Board of Trade, long known as the premier commodity market, *Chicago Board of Trade v. Olsen*, 262 U.S. 1, 33, decided to begin trading in securities derivatives. In its submissions to the SEC, the Board of Trade explained:

> The CBOE itself, the nation's first central market for securities options, evolved from an effort by the Chicago Board of Trade in the late 1960's to develop *futures contracts* in securities. At that time, however, such activity did not fall within the Commodity Exchange Act, the statute governing other Chicago Board of Trade activity. As a result, the plan was modified to qualify it as an options program under the Federal securities laws. Had the plan emerged after the 1974 amendments to the Commodity Exchange Act, when the term "commodity" was broadened to encompass securities and the CFTC was

(Footnote continued on following page)

the proposed options are prohibited under Section 4c(c) of the Commodity Exchange Act, 7 U.S.C. § 6c(c), and that they fall within the CFTC's exclusive jurisdiction over commodity options under Sections 2(a)(1) and 4c(b) of the Act, 7 U.S.C. §§ 2 and 6c(b).[3]

The SEC nevertheless approved the proposed rule changes on February 28, 1981, and the Board of Trade filed this petition for review as a person "aggrieved" by the SEC order. Securities Exchange Act of 1934, § 25(a)(1), 15 U.S.C. § 78y(a)(1).[4] The Board of Trade's petition reiterates its objections to the SEC order based on the Commodity Exchange Act and various CFTC regulations. In addition, the petition for review urges that even apart from prohibitions of the Commodity Exchange Act, under Sections 3(a)(12), 9(b), and 9(f) of the Securities Exchange Act of 1934, 15 U.S.C. §§ 78c(a)(12), 78i(b) and 78i(f), the SEC has no authority to regulate options on GNMA certificates. We will consider the Board of Trade's claims based on the Securities Exchange Act of 1934 although arguably they were not

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[2] *continued*

awarded exclusive regulatory jurisdiction, the Chicago Board of Trade could have retained its original objective of trading securities *futures contracts* on its own floor under the same statute—the Commodity Exchange Act—governing its other activities. The divergence of securities options trading from futures trading was fortuitous, therefore, due to a state of the law at the time that no longer applies.

SEC Record 484. As will be explained *infra*, under the current statutes GNMA futures and options are to be regulated by a single agency, the CFTC, and we are setting aside the SEC's attempt to separate their regulation.

[3] Relevant statutory provisions are set forth in the Appendix.

[4] Regarding the Board of Trade's standing to sue, see *Hill v. Wallace*, 259 U.S. 44, 61 (since unconstitutional "act, if enforced, [would] seriously injure the value of the Board of Trade to its members, and the pecuniary value of their memberships, * * * it was the duty of the Board of Directors to bring an action to resist [the act's] enforcement").

raised before the SEC[5] because the SEC has not objected to our consideration of them and because if the claims are correct the SEC has clearly and unambiguously exceeded its statutory jurisdiction. See K.C. Davis, Administrative Law Treatise § 20.00 at 127-128 (Supp. 1980) ("No matter how clear the statutory or nonstatutory law may be that exhaustion is required, the reviewing court will not require exhaustion if the agency fails to oppose review on grounds of lack of exhaustion."); *First Jersey Securities, Inc. v. Bergen*, 605 F.2d 690, 696 (3d Cir. 1979). The Board of Trade's failure to raise these claims is therefore excusable under Section

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[5] The underlying question of SEC jurisdiction over GNMA options was raised to the SEC by the Board of Trade, SEC Record 479-489, 530, and the CBOE also recognized the jurisdictional question, which it characterized first as "which possible new options products (including GNMA options) appropriately fall within the Commission's jurisdiction and which, instead, come within the jurisdiction of the Commodities Futures Trading Commission [*sic*]" and then again as "whether options on what every one concedes is a security * * * are appropriately subject to the Commission's jurisdiction rather than that of some other agency * * *." SEC Record 283, 284. The latter characterization is precisely the question that the Board of Trade is raising, although the corresponding sections of the Securities Exchange Act are not cited. See also Comment Letter of Mortgage Bankers Ass'n of America, SEC Record 434 ("the proposed contract represents a departure from the equity-based options contracts with which the SEC is familiar and hence requires regulators to venture into a new and technically quite different arena"). Of course it would be irrelevant that other interested parties were more emphatic than the Board of Trade at raising the issue of the SEC's authority under the Securities Exchange Act over GNMA options. *Wilson & Co. v. United States*, 335 F.2d 788, 794 (7th Cir. 1964).

Unfortunately, we are lacking the CFTC's comments to the SEC on jurisdiction. The CFTC had "directed its Office of General Counsel to prepare a legal memorandum on this subject for submission to the Commission [SEC] in the near future," SEC Record 630 (Feb. 10, 1981), but the SEC approved the CBOE rule changes on February 26, 1981—too quickly for the memorandum to be finished.

25(c)(1) of the Securities Exchange Act of 1934, 15 U.S.C. § 78y(c)(1). *Cf. Sartain v. Securities and Exchange Commission*, 601 F.2d 1366, 1375 (9th Cir. 1979) (denial of due process need not have been raised before SEC).[6]

We permitted the CBOE to intervene as a respondent and have had the further benefit of *amicus* briefs filed by the CFTC, the North American Securities Administrators Association, the Philadelphia Stock Exchange, and the Securities Investor Protection Corporation. After hearing oral argument from both Government agencies and both exchanges on November 4, 1981, we stayed the SEC order pending our resolution of this dispute.[7]

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[6] Because of our disposition of this appeal based on the above provisions of the Commodity and Securities Exchange Acts we need not consider the Board of Trade's further assertions that the SEC failed to give sufficient consideration to (1) whether the proposed options would entail "transactions involving contracts of sale of a commodity for future delivery" within Section 2(a)(1) of the Commodity Exchange Act, 7 U.S.C. § 2, and (2) whether the proposed option transactions are transactions "involving the prices of [futures] contracts" prohibited by a CFTC regulation, 17 C.F.R. § 32.2(b).

[7] Two related cases are also pending before this Court. The first, No. 81-2587, is the Board of Trade's petition for review of an SEC order approving rules of the Options Clearing Corporation (the CBOE's clearing house) that would empower it to issue GNMA options and to clear and settle GNMA options transactions and exercises of GNMA options. A second pending petition, No. 82-1097, was brought by the Board of Trade and the Chicago Mercantile Exchange to review an SEC order approving rule changes of the CBOE and American Stock Exchange that would allow trading on the latter of offset options contracts in Treasury bonds, notes, and bills. Unless the parties thereto can convince us otherwise by their briefs, No. 81-2587 is controlled by this decision.

II

The CFTC and SEC have taken opposite stands with respect to their jurisdiction to regulate GNMA options.[8] In its order under review, the SEC has taken the position that the Commodity Exchange Act (CEA) is inapplicable to the trading of options on securities on a national securities exchange such as the CBOE and that it has authority under the Securities Exchange Act of 1934 (SEA) to allow such trading. The CFTC, on the other hand, agrees with the Board of Trade that the attempted SEC designation of commodity options trading is flatly prohibited by Sections 4c(b) and 4c(c) of the CEA. Moreover, the CFTC and Board of Trade argue that the CEA provides a comprehensive and in this instance exclusive regulatory scheme for commodity futures and commodity options transactions. The dispute arises primarily because GNMA's are both "securities"

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[8] While this case was pending, the CFTC and SEC filed with us a copy of a news release announcing their provisional agreement purportedly resolving the jurisdictional dispute at issue in this case. The jurisdictional agreement has not made the case moot, however. Although Congress has provided that the CFTC "maintain communications" with the SEC regarding CFTC activities that "relate" to SEC responsibilities, 7 U.S.C. § 4a(g)(2), and that the CFTC "may cooperate" with the SEC, 7 U.S.C. § 16(a), the two agencies cannot thereby enlarge or relinquish their statutory jurisdictions. *Atchison, Topeka, and Santa Fe Ry. v. I.C.C.*, 607 F.2d 1199, 1203 (7th Cir. 1979); *Fort Pierce Utilities Authority v. United States*, 606 F.2d 986, 995 (D.C. Cir. 1979), certiorari denied, 444 U.S. 842. As noted by the dissent, Judge Campbell especially would have preferred not to decide a jurisdictional turf fight between two federal agencies and their constituents. Nevertheless we cannot allow the CFTC and SEC to reapportion their jurisdictions in the face of a clear, contrary statutory mandate. "[T]he role of the agencies remains basically to execute legislative policy; they are no more authorized than are the courts to rewrite acts of Congress." *Talley v. Mathews*, 550 F.2d 911, 919 (4th Cir. 1977) (overturning the Secretary of HEW's ruling because "in view of the plain language of the Act, [the ruling] is unduly restrictive of his own jurisdiction").

under SEA § 3(a)(10), 15 U.S.C. § 78c(a)(10), and "commodities" under CEA § 2(a)(1), 7 U.S.C. § 2. In disentangling the agencies' jurisdictions, we begin with a review of their respective powers under the CEA.

Expanded Definition of "Commodity"

Before 1974, the Commodity Exchange Act of 1936 applied mostly to agricultural commodities. Essentially all commodity options transactions were prohibited. CEA of 1936, § 4c (current version at § 4c(a), 7 U.S.C. § 6c(a)). In 1974, Congress enacted the Commodity Futures Trading Commission Act, which amended the CEA's definition of "commodity" to include "all other goods and articles, except onions * * *, and all services, rights, and interests in which contracts for future delivery are presently or in the future dealt in * * *." CEA § 2(a)(1), 7 U.S.C. § 2. By this amendment, literally anything other than onions[9] could become a "commodity" and thereby subject to CFTC regulation simply by its futures being traded on some exchange. The legislative history shows that the purpose of the enlarged definition was to allow regulation of futures contracts and other transactions in a growing number of commodities such as coffee, sugar, and foreign currencies that were then being traded on and off commodity exchanges and that had been unregulated under the prior version of the CEA. This language was also meant to encompass futures markets that were expected to be expanded to cover non-traditional goods and services such as GNMA's. See S. Rep. No. 1131, 93d Cong., 2d Sess. 19, reprinted in

[9] Onions were excepted from the amended definition pursuant to Pub. L. 85-839, § 1, 72 Stat. 1013 (1958) (codified at 7 U.S.C. § 13-1), which prohibited all trading in onion futures. Congress had passed the prohibition following complaints by onion producers that price fluctuations in the futures market adversely affected the cash price of onions. See S. Rep. No. 1631, 85th Cong., 2d Sess. (1958); H.R. Rep. No. 1036, 85th Cong., 1st Sess. (1957), reprinted in [1958] U.S. Code Cong. & Ad. News 4210-4215. But see *Precious Metals Associates v. CFTC*, 620 F.2d 900, 905 n.8 (1st Cir. 1980) (suggesting a physiological basis for the onion producers' crying).

[1974] U.S. Code Cong. & Ad. News 5843, 5859; H.R. Rep. No. 975, 93d Cong., 2d Sess. 41-42, 62 (1974); Philip F. Johnson, *The Commodity Futures Trading Commission Act: Preemption as Public Policy*, 29 Vand. L. Rev. 1, 25 (1976) ("Congress was well aware, for example, that a futures contract based upon mortgage interest rates was under development in 1973 and 1974."). Under the expanded definition, the SEC concedes that GNMA's became a commodity when the Board of Trade began trading GNMA futures in 1975.

Bans on Options Trading

At the same time that Congress expanded the definition of commodity, it gave the CFTC the power to regulate all options transactions involving any of the new commodities. CEA § 4c(b), 7 U.S.C. § 6c(b).[10] Section 4c(b) provides that "no person" may trade in the new commodity options except in accordance with the CFTC's rules. Thus "Congress gave the Commission [CFTC] power to extend [the prior prohibition on 'old' commodities] to options involving the previously unregulated commodities and to any 'new' commodities *or* to allow the offer and sale of these options subject to terms and conditions prescribed by the Commission." S. Rep. No. 850, 95th Cong., 2d Sess. 10, reprinted in [1978] U.S. Code Cong. & Ad. News 2087, 2098. In 1976, the CFTC exercised this "plenary rule-making power" to promulgate comprehensive options regulations. *British American Commodity Options Corp. v. Bagley*, 552 F.2d 482, 486-487 (2d Cir. 1977), certiorari denied, 434 U.S. 938. See 17 C.F.R. Part 32. The new regulations failed to check persistent commodity options abuses, however, and the CFTC reacted in the Spring of 1978 pursuant to its Section 4c(b) power by suspending all commodity options trading indefinitely. 17 C.F.R. § 32.11. Congress ratified the ban on options trading later that year by adding Section 4c(c) to the CEA, 7 U.S.C. § 6c(c). By

[10] The long-standing ban against trading options on the "old" (agricultural) commodities listed in CEA § 2(a)(1), 7 U.S.C. § 2, was continued under Section 4c(a), 7 U.S.C. § 6c(a).

Section 4c(c), "no person" may enter into "any commodity option transaction involving any" of the new commodities—including GNMA's[11]—until the CFTC lifts the ban on trading by submitting to Congress for thirty days any proposal for renewed options trading.[12]

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[11] As mentioned above, GNMA's had been a commodity since 1975. Congress was clearly aware at the time it enacted Section 4c(c) that GNMA's were a commodity and it made no distinctions among commodities in imposing the options ban. See, *e.g.*, S. Rep. No. 850, 95th Cong., 2d Sess. 13, reprinted in [1978] U.S. Code Cong. & Ad. News 2087, 2101:

> Recent experience also supports the wisdom of Congress' decision in 1974 to expand the scope of commodities that could become the subject of regulated futures trading. Futures contracts based on these new commodities have enjoyed a rapid expansion. In fact, futures contracts on financial instruments—short term commercial paper, mortgaged-backed certificates guaranteed by the Government National Mortgage Association, Treasury bonds and Treasury bills—are among the most active new contracts currently traded. Many hedgers, including banks, businessmen, and home builders are attracted to these futures contracts as a method for planning their enterprises by ensuring against sudden and expensive decreases in value of the instruments used to finance their commercial operations. This experience establishes that the substantive economic value of futures trading is the same for a farmer, a manufacturer, or a financial institution. Participants in the futures markets utilize the hedging or risk-shifting element of futures contracts, whether the contracts involve soybeans or GNMA's.

[12] The CFTC regulations and the Congressional options ban exempted a limited class of off-exchange options trading between mortgage bankers and other GNMA producers known as the GNMA "standby" market. 17 C.F.R. § 32.4; 7 U.S.C. § 4c(c) (proviso). The dissent notes that the CFTC exemption in Section 32.4 is qualified with the following introductory language: "Except for the provisions of §§ 32.2, 32.8 and 32.9, which shall in any event apply to all commodity option transactions * * *." Section 32.2(b), in particular, provides that options "involving the prices" of commodity futures contracts are prohibited "except under such terms and conditions as the Commission [CFTC] shall prescribe."

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The CFTC has not lifted the ban on GNMA options trading[12] and therefore the CBOE cannot trade GNMA

[12] *continued*
Therefore, the dissent argues, the producer exemption of Section 32.4 (which specifically applies to options such as the GNMA "standbys") is inapplicable to GNMA standbys because they are "absolutely prohibited" under Section 32.2(b). On the contrary, we think that the "terms and conditions" that Section 32.2(b) addresses are fulfilled when the GNMA standbys meet the test of Section 32.4, since otherwise Section 32.4 would have no exempting effect at all. Most likely, in placing a Section 32.2 exception at the head of the Section 32.4 producer exemption, the CFTC was concerned with maintaining the absolute prohibition against options on agricultural commodities of Section 32.2(a).

[13] The CFTC has met the prerequisites of Section 4c(c) to allow trading of options on GNMA futures. On September 8, 1981, the CFTC adopted regulations to govern a pilot program of trading in certain commodity transactions. 46 Fed. Reg. 54500 (Nov. 3, 1981). The new program and supporting memoranda were submitted to Congress as required by Section 4c(c), and the specified time period for Congressional objection has expired. See 46 Fed. Reg. 54570 (Nov. 3, 1981). The CBOE erroneously argues that the trading ban of Section 4c(c) is thereby lifted with respect to GNMA options. The statutory ban on entering into any particular commodity option transaction is lifted only when "(1) the Commission [CFTC] transmits to the House Committee on Agriculture and the Senate Committee on Agriculture, Nutrition, and Forestry documentation of its ability to regulate successfully such transactions, including a copy of the Commission's proposed rules and regulations, and (2) [upon] the expiration of thirty calendar days of continuous session of Congress after the date of such transmittal." CEA § 4c(c), 7 U.S.C. § 6c(c). The question raised by the CBOE, then, is whether GNMA options are among the transactions that were impliedly approved by Congress when the CFTC submitted its pilot program of September 8, 1981. We regard the new regulations themselves to be the principal evidence of what transactions the CFTC claimed to be able to regulate and thus what transactions Congress approved. By its new Section 33.4, the CFTC's pilot program is limited to options on commodity futures. See 46 Fed. Reg. 54530 (Nov. 3, 1981). Similarly, the memorandum submitted to Congress in support of the CFTC's regulatory

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ability and CFTC Chairman Philip McBride Johnson's testimony before the House Subcommittee on Conservation, Credit and Rural Development were limited to CFTC regulation of options on commodity futures. Therefore the CFTC has not demonstrated nor has the Congress passed over the CFTC's ability to regulate commodity options, and the ban of Section 4c(c) remains.

On February 16, 1982, the CFTC proposed for adoption a new regulation that purportedly "would remove any possibility that the prohibitions in Section 4c(c) and CFTC Rule 32.11 [17 C.F.R. § 32.11] as well as Parts 32 and 33 of the CFTC's regulations would impede trading in options on exempted securities on national securities exchanges subject to regulation by the SEC." 47 Fed. Reg. 7677, 7678 n. 2 (Feb. 22, 1982). The proposed regulation was submitted to the appropriate Congressional committees on February 19, 1982, and the CBOE has argued that the ban on GNMA options trading will be lifted should Congress take no action for the required thirty days of continuous session. The proposed regulation apparently does not, however, comply with the requirements for lifting the options ban of Section 4c(c). The proposed regulation states:

> § 34.1 *Commodity Option Transactions on Exempted Securities, Certificates of Deposit and Foreign Currencies*
>
> The provisions of Parts 32 and 33 of this chapter shall not apply to any commodity option transaction involving an option on any exempted security, [such as a GNMA certificate,] * * * that is traded on a national securities exchange registered with the Securities and Exchange Commission * * *.

The proposed regulation evidently would only relinquish CFTC jurisdiction in favor of the SEC and would not, as Section 4c(c) requires, document the *CFTC's* ability to regulate options on exempted securities. Of course, the CFTC has not adopted this regulation and the required period for implied Congressional approval has not elapsed. We need not decide whether the options ban would be lifted because the CBOE argument is premature. The CBOE's motion to dismiss the petition as moot is therefore denied.

To recapitulate, the Board of Trade trades GNMA futures and the CFTC has recently adopted a pilot program that will allow trading in options on GNMA futures, but the options ban is still in place regarding GNMA options.

options. Moreover, the proposed options trading would not conform with the regulations promulgated by the CFTC pursuant to Section 4c(b) that were in effect at the time of the SEC order,[14] and would also violate various of the new CFTC regulations that on a limited basis permit options trading on commodity futures.[15] For these reasons, the SEC order under review must be set aside.

The CFTC Exclusive Jurisdiction and SEC Savings Clauses

The SEC and CBOE make several arguments that Section 4c(c) and the regulations promulgated under Section 4c(b) do not apply to GNMA options traded on a national securities exchange. The first argument is based upon Congress' attempt in 1974 to divide jurisdiction between the CFTC and SEC with two proviso clauses to Section 2(a)(1) of the CEA, 7 U.S.C. § 2, the "CFTC exclusive jurisdiction" and "SEC savings" clauses:

> *Provided*, That the Commission [CFTC] shall have exclusive jurisdiction with respect to accounts, agreements (including any transaction which is of the character of, or is commonly known to the trade as, an "option", "privilege", "indemnity", "bid", "offer", "put", "call", "advance guaranty", or "decline guaranty"), and transactions involving contracts of sale of a commodity for future delivery, traded or executed on a contract market designated pursuant to section 5 of this Act [7 U.S.C. § 7] or any other board of trade, exchange, or market
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[14] In particular, the proposed trading would have violated 17 C.F.R. § 32.11, which prohibited all commodity options trading with only limited exceptions for merchants in the underlying commodity during the course of their business, 17 C.F.R. § 32.4(a), and for special cases of the public interest as determined by the CFTC. 17 C.F.R. § 32.4(b).

[15] See, *e.g.*, new § 33.4, 46 Fed. Reg. 54530 (Nov. 3, 1981) (limiting options trading to "options on contracts of sale for future delivery").

> *And provided further*, That except as hereinabove provided, nothing contained in this section shall (i) supersede or limit the jurisdiction at any time conferred on the Securities and Exchange Commission or other regulatory authorities under the laws of the United States or of any State, or (ii) restrict the Securities and Exchange Commission and such other authorities from carrying out their duties and responsibilities in accordance with such laws.

The SEC and CBOE contend that options on GNMA's do not fall within the CFTC exclusive jurisdiction clause and therefore are "saved" from the options ban by the SEC savings clause. The Board of Trade, to the contrary, asserts that because the savings clause is limited by the introductory phrase "nothing contained in this section," any SEC jurisdiction over GNMA options is not saved to the extent it is taken away by other Sections, such as the options ban Sections 4c(b) and 4c(c). The "thing" contained in Section 2(a)(1) of concern to the SEC and CBOE, however, is the expanded definition of "commodity." The SEC and CBOE would have us read Sections 4c(b) and 4c(c) as limited by the breadth of "commodity," which being defined in "this section" (Section 2(a)(1)) cannot be used to derogate from "jurisdiction at any time conferred" on the SEC. We agree with this part of their interpretation; the options ban would not possibly impinge on SEC jurisdiction unless the definition of commodity grew to include "securities" regulated by the SEC. Since the definition of commodity occurs in "this section," the savings clause may indeed limit the options ban. Furthermore, the other limiting introductory phrase—"except as hereinabove provided"—does not except the definition of commodity from the savings clause, although the definition occurs "hereinabove." "[E]xcept as hereinabove provided" refers only to above-mentioned proviso clauses, of which there is but one in Section 2(a)(1), the exclusive jurisdiction clause.[16]

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[16] Possibly "provided" could be given its ordinary meaning as anything at all that Congress has set down into legislation,

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Thus we interpret the savings clause so that an expanded definition of commodity does not divest the SEC of jurisdiction, via the options ban or otherwise, except where SEC jurisdiction is divested by the CFTC exclusive jurisdiction clause. Our construction of the savings clause does not aid the SEC and CBOE position, however, because we conclude that GNMA options are within the exclusive jurisdiction of the CFTC and also that under the SEA, the SEC has no power to be saved over GNMA options.

The Exclusive Jurisdiction Clause Covers Commodity Options

Since options are among the listed agreements with respect to which the CFTC has exclusive jurisdiction, GNMA options come within the exclusive jurisdiction clause provided they "involv[e] contracts of sale of a commodity for future delivery." CEA § 2(a)(1). The diffi-

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[16] *continued*

rather than the special meaning of referring to proviso clauses. In particular, Congress might be deemed to have "provided" the CFTC with a broad definition of commodity. The SEC savings clause would then be limited to derogations of SEC jurisdiction that accrue within Section 2(a)(1) but typographically below the text of the savings clause itself. Since the only portions of Section 2(a)(1) that potentially intrude on SEC jurisdiction—the definition of commodity and the exclusive jurisdiction clause—are both located above the savings clause, the savings clause would become superfluous under this reading of "provided." That is, the SEC would retain whatever jurisdiction the CFTC did not take away, with or without the savings clause. The maxim of construing each part of a statute to mean something and our understanding that Congress meant to safeguard traditional SEC jurisdiction, however, impel us to impart to the SEC savings clause the meaning given in the text. See Philip F. Johnson, *The Commodity Futures Trading Commission Act: Preemption as Public Policy*, 29 Vand. L. Rev. 1, 13-15 (1976) (arguing that "except as hereinabove provided" was added by Congress only in order to reconcile the exclusive jurisdiction and savings clauses); Greenstone, *The CFTC and Government Reorganization: Preserving Regulatory Independence*, 33 Bus. Law. 163, 208-209 (1977).

culty lies in the word "involve." The SEC and CBOE argue that GNMA options do not "involve" futures contracts because by their interpretation of the exclusive jurisdiction clause, options can "involve" futures contracts only by being on futures contracts. That is, the CFTC would have exclusive jurisdiction for options on futures contracts, but not for options merely on the underlying commodity.

We disagree. Congress understood the difference between "transactions in" and "transactions involving."[17]

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[17] For example, the so-called "Treasury amendment" of Section 2(a)(1), 7 U.S.C. § 2, distinguishes "transactions in" from "transactions involving." See pages 34-36 *infra*. Similarly, the definition of commodity was expanded to include "all other goods and articles, except onions * * *, and all services, rights, and interests *in* which contracts for future delivery are presently or in the future dealt *in* * * *." Page 10 *supra* (emphasis added). See also 7 U.S.C. § 6c(a)(B) ("transaction involving any commodity" useful for hedging and price-discovery includes "option"); 7 U.S.C. § 13(e) ("transaction in commodity futures," "transaction in an actual commodity," and "transaction of the character of * * * an option" distinguished).

The dissent argues that we put too much stress upon prepositions with this analysis. The dissent has invented another explanation for Congress' use of the word "involving" (none of the parties were so clever): that although the preposition "in" might be fine for connecting "transactions" to "contracts of sale of a commodity for future delivery," "involving" was grammatically the better connector for "accounts" and "agreements." Dissent pages 67-69. But given the choice of drawing meaning from Congress' use of different terms or supposing that Congress drafted the statute imprecisely for the sake of grammar, we have chosen the former.

The dissent also seems to argue that by placing the CFTC's authority to make options regulations and the options ban in a separate Section (4c) from the exclusive jurisdiction clause (2(a)(1)), Congress must not have intended the CFTC's options authority to be exclusive. Dissent page 65. It does not seem "nonsensical" to us, however, that Congress delimited the CFTC's exclusive jurisdiction over all commodity transactions in one Section, while putting special controls on options

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Had Congress meant to limit CFTC exclusive jurisdiction to transactions in commodity futures, it would have said so. See *American Stock Exchange, Inc. v. CFTC*, 528 F. Supp. 1145, 1151-1152 (S.D.N.Y 1982) (recognizing that commodity options are within CFTC exclusive jurisdiction).

Instead, the legislative history clearly indicates that Congress intended "transactions involving" to import something more than "transactions in" (or options on) commodity futures. Following lobbying led by the Chicago Board of Trade to give a single agency exclusive jurisdiction over commodity transactions, the House Committee on Agriculture revised its draft bill to read: "the Commission [CFTC] shall have exclusive jurisdiction of transactions dealing in, resulting in, *or relating to* contracts of sale of a commodity for future delivery * * *." *Hearings on S. 2485, S. 2578, S. 2837 & H.R. 13,113 Before the Senate Committee on Agriculture & Forestry*, 93d Cong., 2d Sess. pt. 1 at 140-141 (1974) (emphasis added). See Johnson, *supra*, 29 Vand. L. Rev. at 10-11.[18] Since "transactions dealing in [and] resulting

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[17] *continued*

trading in another Section. Options transactions were given special attention in a separate section because they historically had been abused and because the Congress chose to treat options on "old" commodities, options on "new" commodities, and trade options differently. Compare CEA § 4c(a), (b), and (c) (proviso), 7 U.S.C. § 6c(a), (b), and (c) (proviso). That options regulation is centered generally in Section 4c is hardly probative of the scope of CFTC exclusive jurisdiction regarding options just because the latter is in a different Section of the statute. Similarly, there is little probative to the scope of CFTC exclusive jurisdiction from Congress' using different standards in Sections 2(a)(1) ("'option' * * * involving contracts of sale of a commodity for future delivery") and 4c(b) ("any transaction * * * involving any * * * commodity which is of the character of, or is commonly known to the trade as, an 'option'"). It is quite "sensible" to us that the CFTC's exclusive jurisdiction over commodity options should be more limited than its general, nonexclusive commodity options powers.

[18] Mr. Johnson, who has since become Chairman of the CFTC, reasoned later in his article that because "options,

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in" futures contracts cover trading in both futures and options on futures, by including the third category "transactions * * * relating to" futures the House draft would have extended CFTC exclusive jurisdiction to trading of futures-related instruments such as commodity options. Similarly, the Senate committee, whose version of the exclusive jurisdiction clause was adopted by the conference committee[19] and enacted, explained that "(a) the Commission's [CFTC's] jurisdiction over futures contract markets or other exchanges is exclusive and includes the regulation of commodity accounts, commodity trading agreements, *and commodity options*; (b) the Commission's jurisdiction, where applicable, supersedes State as well as Federal agencies * * *." S. Rep. No. 1131, 93d Cong., 2d Sess. 6 (1974), reprinted in [1974] U.S. Code Cong. & Ad. News 5843, 5848 (emphasis added).[20]

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[18] *continued*
when exercised, do not result in the delivery of a futures contract," they are not within CFTC exclusive jurisdiction. 29 Vand. L. Rev. at 15 n. 45. Mr. Johnson thus supposed at one point that only options on futures are within the CFTC's exclusive jurisdiction, but he could cite no authority for this mistaken proposition.

[19] See S. Conf. Rep. No. 1194, 93d Cong., 2d Sess. 35 (1974); H. Conf. Rep. No. 1383, 93d Cong., 2d Sess. 35, reprinted in [1974] U.S. Code Cong. & Ad. News 5894, 5897.

[20] The identical language was reiterated in the House and Senate Conference Reports. S. Conf. Rep. No. 1194, 93d Cong., 2d Sess. 35 (1974); H. Conf. Rep. No. 1383, 93d Cong., 2d Sess. 35, reprinted in [1974] U.S. Code Cong. & Ad. News 5894, 5897. The dissent quotes language from these reports stating that CFTC jurisdiction preempts State law regulating futures trading, see dissent page 79, but that is irrelevant here. See also 120 Cong. Rec. 34737 (1974) (remarks of Rep. Poage) (emphasis added):

> [Considering the] broad category of arrangements and contracts relating to investments [called "investment contracts,"] there may be some apparent overlap between the jurisdiction of the Securities and Exchange Commission and the intended jurisdiction of the Commodity Futures Trading Commission over trading in futures contracts

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One difficulty in searching the legislative history for evidence of an intended distinction between options and options on futures is that the phrase "commodity option" may have been used ambiguously to mean either.[21] The only distinction between the two options was made by sponsoring Chairman Poage of the House Committee on Agriculture, who explained that the CFTC was created in order "to fill all regulatory gaps—to regulate trading in futures and *in options relating to commodities or commodity futures*, because such trading is now poorly regulated if it is regulated at all." 120 Cong. Rec. 34736 (1974) (emphasis added).

We conclude that Congress chose the phrase "'option' * * * *involving* contracts of sale of a commodity for future delivery" in order to give the CFTC exclusive jurisdiction over at least some commodity options, although it is less clear how far the exclusive jurisdiction was meant to extend into options on commodities like GNMA's that double as securities. Given the possible expansion of "commodity" to include even corporate securities on which options have traditionally been regulated by the SEC, the CFTC exclusive jurisdiction clause must have some limits.

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[20] *continued*

relating, or purporting to relate, to tangible commodities. It was not intended that the jurisdiction of the Securities and Exchange Commission with respect to investment contracts be superseded, *except to the extent that jurisdiction is granted to the CFTC with respect to contracts for future delivery or options relating, or purporting to relate, to tangible commodities* * * *.

See note 1 *supra* regarding meaning of the phrase "tangible commodity."

[21] For example, in its new regulations governing the pilot program for options on commodity futures, the CFTC has defined "commodity option" to include both options and options on futures. See new § 1.3(hh), 46 Fed. Reg. 54516 (Nov. 3, 1981).

Congress Did Not Limit Power Over Commodities to Non-Securities

The SEC and CBOE argue that even if a distinction cannot be made between commodity options and options on commodity futures, Congress did not intend to give the CFTC exclusive jurisdiction over transactions involving securities. The SEC and CBOE base their argument upon snippets in the legislative history that purportedly suggest a clean jurisdictional division between commodities and securities. For example, the Senate Committee on Agriculture and Forestry discussed the scope of the CFTC's option authority under Section 4c(b) in these terms:

> The Committee intends that options not be traded except on organized exchanges and in conformity with the rules and regulations of the Commission [CFTC]. However, the Commission would not have authority to regulate trading in puts and calls for securities. Where traded on exchanges, these puts and calls are regulated by the Securities and Exchange Commission.

S. Rep. No. 1131, 93d Cong., 2d Sess. 26, reprinted in [1974] U.S. Code Cong. & Ad. News 5843, 5866. This passage does not describe CFTC power under the exclusive jurisdiction clause of Section 2(a)(1), although it does describe an important grant of CFTC power regarding options regulation, Section 4c(b). But crucially the passage fails to define what is meant by "securities"; the Senate Committee makes no distinction between traditional, corporate stocks and the extension of "security" here to include non-traditional instruments traded and regulated under the CEA for some six years as "commodities."[22] Similarly, a passage such as "The

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[22] The Senate Committee's failure to state explicitly that preserved SEC jurisdiction over "securities" should be read expansively is telling because there is also some language in the CEA legislative history to support the Board of Trade's argument that Congress intended to preserve only SEC authority over "traditional" corporate stocks and the like. For

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Commission will have exclusive jurisdiction over options trading in commodities (but not in securities)" does not cleave the agencies' jurisdictions but instead perhaps reflects a committee member's belief that commodities and securities could remain mutually exclusive. *Id.* at 31, [1974] U.S. Code Cong. & Ad. News at 5870. The Senate Committee, of course, had no reason to make subtle distinctions between traditional stocks and their new

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example, House Committee Chairman Poage stated on the House Floor:

> With respect to the definition of commodities, it was intended to apply to a broader class of goods, articles, rights and interests than previously were subject to the Commodity Exchange Act. It was not intended, however, to apply to trading in interests and rights *traditionally known as securities*, including, *for example, stocks, corporate bonds, warrants, and debentures*, nor was it intended to apply to trading in options to purchase any of the foregoing.

120 Cong. Rec. 34737 (1974) (emphasis added). See also 120 Cong. Rec. 34997 (1974) (identical remarks of Senate Committee Chairman Talmadge). Similarly, during the 1978 amendments to the CEA, the Senate Committee on Agriculture, Nutrition, and Forestry defused concern over expanding CFTC jurisdiction as follows:

> In order to avoid duplication and confusion in the regulation of futures trading, the Commission created by the 1974 Act was given exclusive jurisdiction over all accounts, agreements (including options) and transactions involving futures contracts. Futures contracts are not written on individual industrial equities. Put and call options to sell or purchase individual exchange-traded industrial equities are now traded on securities exchanges. Regulation of these options is under the jurisdiction of the SEC, which regulates the exchanges on which these options are traded and oversees a comprehensive system of disclosure by the issuers of the underlying industrial equities.

S. Rep. No. 850, 95th Cong., 2d Sess. 21-22, reprinted in [1978] U.S. Code Cong. & Ad. News 2087, 2109-2110. GNMA's are not traditional, industrial stocks. See pages 27, 42 nn.40-41, 46-48 *infra*.

commodities because in 1974 the SEC had not yet attempted to regulate trading of the latter.[22]

The dissent argues that Congress did not intend to preempt SEC jurisdiction on national securities exchanges subject to its regulation. There are a few places in the legislative history that could be strained to suggest this interpretation. For example, House Committee Chairman Poage stated:

> This grant of exclusive jurisdiction [to the CFTC] is not to be construed as preempting the jurisdiction of the Securities and Exchange Commission over securities, including *stock options*, traded on any national securities exchange or any other U.S. securities market.

120 Cong. Rec. 34737 (1974) (emphasis supplied). If jurisdiction were to be assigned by market, the dissent does not state how it would then limit the SEC jurisdiction so that the CBOE could not trade wheat options or onion futures, but we need not speculate what the CBOE may do in order to refute the argument. The exclusive jurisdiction clause states specifically that the CFTC has exclusive jurisdiction over the enumerated transactions whenever "traded or executed on a contract market designated pursuant to section 5 of this Act [7 U.S.C. § 7] *or any other board of trade, exchange, or market* * * *." 7 U.S.C. § 2 (emphasis added). The dissent thus reads the legislative history inconsistently with the clear words of

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[22] Likewise, in a 1975 letter cited by the dissent (page 32), the CFTC had been given no reason to consider the issue in this case. See [1975-1977 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,117, at 20,834-20,835 (1975). In that letter, the CFTC stated that its exclusive jurisdiction over instruments such as GNMA's was "solely with respect to futures trading in those instruments." But this statement was made only to show that it had no interest in regulating the underlying "cash market," not to show that it thought it had no power over other commodity derivatives which were "with respect to [pre-existing] futures trading." Compare 41 Fed. Reg. 51808 (Nov. 24, 1976) ("The authority granted to the Commission [CFTC] to regulate commodity option transactions is extremely broad.").

the statute, which divide jurisdiction by transactions rather than markets, and the statute must control. The statute also suggests a more plausible reading of the legislative history: that Congress in 1974 meant to protect SEC jurisdiction over the sorts of corporate stock options then being traded on national securities exchanges. Accordingly, the legislative history's reference to national securities exchanges is only illustrative of the instruments within the SEC's saved jurisdiction and does not compel a division of power according to what market an instrument is traded on.

Our construction of the exclusive jurisdiction clause as including power over at least some commodity/security options is reinforced by subsequent legislative events. In 1975, the SEC attempted to add a provision in the 1975 amendments to the SEA that would have repealed the CFTC's grant of exclusive jurisdiction with respect to all "transactions involving a 'security.'" *Hearings on S. 249 Before the Senate Subcommittee on Banking, Housing, and Urban Affairs*, 94th Cong., 1st Sess. 244 (1975). SEC Chairman Ray Garrett, Jr. stated in a letter of comment requested by Chairman Harley O. Staggers of the House Committee on Interstate and Foreign Commerce that without the amendment, the CFTC's exclusive jurisdiction "may well call into question the continuing jurisdiction of the Securities and Exchange Commission over options trading, including that on the Chicago Board Options Exchange and the American Stock Exchange, Inc." *Id.* at 204, 209.[24] Congress rejected the proposed reduction of CFTC jurisdiction, and the CFTC retains its exclusive jurisdiction over options that "involve" commodity futures even though the commodities may also be securities.

In 1978, the SEC again attempted to have "securities" withdrawn from CFTC power and also to extend the

[24] The letter refers to "continuing jurisdiction" because at the time it was written, February 14, 1975, the 1974 amendments to the CEA had not gone fully into effect. Pub. L. 93-463, § 418 (1974). Thus the SEC Chairman correctly anticipated some displacement of what he believed to be pre-existing SEC authority over options trading.

definition of security in each of the five Federal securities laws. *Extend Commodity Exchange Act: Hearings on H.R. 10285 Before the House Subcommittee on Conservation and Credit*, 95th Cong., 2d Sess. 181-210 (1978) (testimony of SEC Chairman Harold M. Williams); H.R. Rep. No. 1181, 95th Cong., 2d Sess. 12-14 (1978); S. Rep. No. 850, 95th Cong., 2d Sess. 20, 21, 52-55, reprinted in [1978] U.S. Code Cong. & Ad. News 2087, 2108, 2109, 2140-2143.[25] Congress again rejected the SEC proposals, but added 7 U.S.C. § 4a(g)(2) to the CEA, which directs the CFTC to "maintain communications" with the SEC and other agencies in order to keep "such agencies fully informed of Commission activities" relative to their responsibilities. See Bromberg, *Securities Law—Relationship to Commodities Law*, 35 Bus. Law. 787, 791 (1980) ("[T]he SEC has never really accepted the [CFTC] exclusive jurisdiction language, and has continued to argue that the language does not say what it pretty obviously does say and what Congress said in 1978 it obviously meant."). As noted above, Congress in 1978 was aware that GNMA's were among the new commodities but made no distinctions when imposing the options ban between GNMA's (or other commodity/securities) and other new commodities. See *International Trading, Ltd. v. Bell*, 556 S.W.2d 420, 424-425 (Ark. 1977) (In Banc) ("The argument that [CFTC exclusive jurisdiction] relates only to regulation of commodities, not securities, is unavailing here because of the clear language of the act bringing commodity options within the purview of the act.").

The above discussion does not mean there are no limits to CFTC power over options on securities but only that we reject (as did Congress) the SEC's and CBOE's contention that the CFTC has no power over options on securities. The need for some limits upon CFTC power, however, remains.

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[25] In a letter from the SEC Chairman to Senator Leahy, the former specifically "recommended that the SEC be granted jurisdiction over futures and options trading on any security * * *." S. Rep. No. 850, 95th Cong., 2d Sess. 21, reprinted in [1978] U.S. Code Cong. & Ad. News 2087, 2109.

Limits on the Exclusive Jurisdiction Clause

Since this is only the first case construing the extension of CFTC exclusive jurisdiction into options on securities, we have not attempted to divine the limits that a series of cases involving different commodity/securities may better establish. Rather, we have considered several rationales for separating exclusive CFTC jurisdiction from that reserved to the SEC based in the legislative materials and the logic of the overall legislative scheme.

One set of limits for the options aspect of the exclusive jurisdiction clause arises from the 1974 legislative history suggestion that only "traditional" SEC authority over corporate securities was to be preserved. See note 22 *supra*. GNMA's are not traditional securities; the regular payments of principal and interest that they represent, unlike corporate dividends, are guaranteed by the Government for the life of the certificate. Accordingly, GNMA's are exempted from many of the provisions of the Federal Securities Acts that apply to traditional stocks. See pages 42, 46 *infra*. It would seem then Congress intended non-traditional securities such as GNMA's to be within the CFTC's exclusive jurisdiction once the underlying security became a commodity by the opening of a legitimate futures market.

Another reasoned limitation on the scope of the exclusive jurisdiction clause is based on the purposes for which the commodity future or commodity option is traded. The district court in *Mullis v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 492 F.Supp. 1345 (D. Nev. 1980) took this tack. In summarizing the 1974 legislative history it stated:

> The jurisdiction of the CFTC preempts all other agency regulation in the commodities field, even regulation of a security, *so long as the dominant purpose for the existence of the security is to trade in commodity futures* * * *.

492 F.Supp. at 1350 (emphasis added). During the 1978 amendments to the CEA, the Senate Committee on Agriculture, Nutrition, and Forestry suggested a similar, functional approach:

> The committee has followed with interest the changing nature of futures markets. The nature of the underlying commodity is not an adequate basis to divide regulatory authority. Further, the fact that a futures contract market does not fit into the traditional mold where there are both hedging and price-discovery functions should not be the determining factor in whether the contract is to be regulated by the CFTC. *So long as the futures contract serves a legitimate function, Congress has vested the Commodity Futures Trading Commission with jurisdiction.*

S. Rep. No. 850, 95th Cong., 2d Sess. 22, reprinted in [1978] U.S. Code Cong. & Ad. News 2087, 2110 (emphasis added).

None of the parties suggests that GNMA's are not "legitimate" commodities.[26] The parties also agree that GNMA futures serve the legitimate and important functions of allowing mortgage bankers to better anticipate changes in mortgage interest rates and to transfer the risks due to fluctuation in mortgage interest rates to speculators willing to assume them. The "dominant purpose" for the existence of GNMA's is not that they be traded as futures, but a sort of converse is correct: "by providing a degree of liquidity for mortgage investments," GNMA futures further the purposes for the existence of the underlying GNMA's. 12 U.S.C. § 1716(a). Indeed, the CBOE proposal under review was greeted with enthusiasm by both mortgage bankers and the Government National Mortgage Association as a new means to facilitate their activities in the housing market. SEA Release No. 17577, at 4-6 (Feb. 26, 1981); SEC Record 327-472. GNMA futures or options are in this respect functionally quite similar to soybean futures or options, in that their trading serves legitimate hedging and price discovery functions, thereby facilitating

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[26] The dissent suggests what it considers to be several "illegitimate" commodities (*e.g.*, American Telephone and Telegraph bonds), but we need express no opinion here on that suggestion.

production of the underlying commodity. See S. Rep. No. 850, 95th Cong., 2d Sess. 13 (quoted in note 11 *supra*).

GNMA futures are not identical to GNMA options, however, and there is some indication that mortgage bankers would prefer to trade in GNMA options.[27] Nevertheless, both instruments are claimed to serve more or less the same purposes, and the prices in each

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[27] See, *e.g.*, SEC Record 350 (when quantity to be hedged is unknown, options preferred), 365-366 (futures are "not a consistently useful vehicle for hedging the risks present in the conventional loan origination market"), 426-427 ("mandatory aspect" of the futures contract undesirable).

This would not be the first time, however, that Congress has frustrated would-be options traders out of concern for its larger constituency. Prior to enactment of the CEA in 1936, Mr. James J. Coughlin, a member of the Chicago Board of Trade, presented the Senate Committee on Agriculture and Forestry a petition "signed by something in excess of 1,500 members of the contract grain markets" requesting that the prohibition against trading "indemnities" be lifted. *Hearings on H.R. 6772 Before the Senate Committee on Agriculture & Forestry* 137-138 (1936). Indemnities were options on commodity futures whose trading would, in the judgment of Mr. Coughlin's petitioners, "result in a substantial broadening of the capacity of the futures markets to absorb the great volume of hedges necessarily attendant upon crop movements and, to that extent, furnish an infinitely more liquid market than exists at present, thereby not only resulting in a higher price level but likewise reducing the necessary price differential between farm and terminal." *Id.* But there was also substantial testimony from farm organizations and others to the effect that "this character of transaction [is] the cheapest form of gambling that can be practiced." *Id.* at 222 (statement of Mr. Clifford Thorne). In 1936, Congress sided with those wary of options by enacting the original Section 4c. CEA of 1936, ch. 545, § 4c, 49 Stat. 1491, 1494 (now codified as § 4c(a), 7 U.S.C. § 6c(a)). In 1974, to the displeasure of putative options traders, Congress again sided with the cautious by placing all commodity options trading within the authority of a single independent agency. In 1978, Congress went even further by generally banning all options trading.

market assumedly would affect one another.[28] Moreover, the fears that prompted the 1974 and earlier legislation,

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[28] For example, in 1978, SEC Chairman Williams testified to the economic near-equivalence of options and futures:

> More specifically, futures on financial securities are directly comparable to options on securities. At the most fundamental level, financial futures and securities options are both devices for risk management in relation to price fluctuations in the underlying securities. They are both derivative financial instruments, because their prices are determined primarily by the prices of the underlying securities traded on other markets. By using financial futures or securities options, investors can pursue a high-risk investment strategy. They can pay a relatively small amount of money—a margin for a future, or a premium for an option—in return for the opportunity of reaping a proportionately large profit or suffering a proportionately large loss.
>
> Moreover, securities futures and securities options raise similar policy concerns from the perspective of their impact on the American economy. Neither securities futures nor options on securities lead directly to new capital formation. American businesses raise capital by selling the securities underlying these futures and options; those businesses do not obtain any input of capital when investors purchase futures or options on these securities. In fact, some investors may choose to purchase securities futures and securities options instead of purchasing the underlying securities.
>
> To be sure some differences do exist between securities futures and securities options. A futures contract represents a binding obligation which must be satisfied on the expiration date, unless it is liquidated by an offsetting transaction. An option constitutes a right exercisable at any time by the holder of the option. But, this difference is mitigated by the existence of a continuous market for futures before the expiration date. While investors may make a small deposit for a futures contract, and pay a premium for an options contract, the potential risk of loss assumed by investors is different. In an options contract, the maximum loss for the purchaser is the amount of the premium. In a futures contract, as the market moves against the participant, additional margin calls are made.

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concerning manipulation of commodity prices by speculators in commodity derivatives, apply equally to both options and futures. 7 U.S.C. § 5; *Hearings on H.R. 6772 Before the Senate Committee on Agriculture and Forestry* 18-22, 172-173, 182-185, 186-187, 214 (1936); Greenstone, *The CFTC and Government Reorganization: Preserving Regulatory Independence*, 33 Bus. Law. 163, 177-181 (1977). And the evidence presented to the SEC overwhelmingly indicated that opportunities for manipulation would be increased by addition of a GNMA options market regulated by a separate agency, although the effects of increased attempts at manipulation could not be foreseen. See, *e.g.*, SEC Record 527, 636-640.[29] Congress quite clearly intended "to create one

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[28] *continued*

But, again, this difference is mitigated by the ability of a holder of a futures contract to liquidate the contract at any time before the expiration date.

Thus, despite the technical differences between futures on securities and options on securities, in a pragmatic vein the two investment vehicles are distinctly similar. At the most basic level, the prices of both futures on securities and options on securities are primarily dependent on the same factor—the price of the underlying security.

* * *

The regulatory implications of the essentially derivative nature of the prices of securities futures and securities options are most important. * * * In short, since the prices of futures and options on securities are primarily dependent on the prices of the underlying securities, the regulation of the markets for these futures, options, and underlying securities needs to be integrated.

Extend Commodity Exchange Act: Hearings on H.R. 10285 Before the House Subcommittee on Conservation and Credit, 95th Cong., 2d Sess. 193-196 (1978). See also *id.* at 217-219 (statement of CBOE President Joseph W. Sullivan); Moriarty, Phillips & Tosini, *A Comparison of Options and Futures in the Management of Portfolio Risk*, Financial Analysts J. 61 (Jan./Feb. 1981).

[29] See also SEC Chairman Williams' 1978 testimony:

The present bifurcated system—under which the CFTC claims regulatory authority over the markets for futures

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federal agency with the expertise to regulate the commodities industry,"[30] and its prudent choice should be given effect here. Since GNMA's are not traditional stocks and GNMA options have the character of a legitimate commodity derivative, we hold that the proposed GNMA options "involve" the pre-existing GNMA futures and therefore are within the exclusive jurisdiction of the CFTC.[31]

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[29] *continued*

on securities, while this Commission regulates the markets for the underlying securities, and for options on these securities—creates surveillance difficulties for both agencies. For example, one market may be manipulated to benefit a position held in the other market. Detection of such a manipulation, and subsequent enforcement action, can only be effective if both markets are regulated by the same agency.

Extend Commodity Exchange Act: Hearings on H.R. 10285 Before the House Subcommittee on Conservation and Credit, 95th Cong., 2d Sess. 196 (1978).

[30] Russo & Lyon, *The Exclusive Jurisdiction of the Commodity Futures Trading Commission*, 6 Hofstra L. Rev. 57, 90 (1977). See 119 Cong. Rec. 41335 (1973) (remarks of House Chairman Poage); H.R. Rep. No. 975, 93d Cong., 2d Sess. 69-71 (1974).

[31] The dissent argues that GNMA options do not "involve" any futures contract because the word "involving" was borrowed from earlier commodities legislation, namely Section 3 of the Grain Futures Act of 1922, ch. 369, 42 Stat. 999. Section 3 of the 1922 Act did not cover options; ergo, the 1974 amendments to CEA § 2(a)(1) cannot either.

The use of the word "involving" in Section 3 of the 1922 Act is not probative for two reasons. First, there is nothing to rebut the probability that "involving" was used in the two statutes only coincidentally. There are no statements in the 1974 legislative history indicating that Congress adopted the word used in 1922 for any purpose, let alone for incorporating its settled meaning. The 1974 House draft used "relating" rather than "involving," the latter appearing only in the Senate version and without explanation for the change. See pages 19-20 *supra*. Whereas Section 2(a)(1) carefully delineates the scope of Congress' 1974 regulation, Section 3

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[31] *continued*
was enacted only to explain why futures trading affects interstate commerce and therefore why futures trading should be regulable under the Commerce Clause. See *Chicago Board of Trade v. Olsen*, 262 U.S. 1 (1922 Act is constitutional under the Commerce Clause). The 1922 Act was passed in response to an earlier Supreme Court decision holding parts of the Future Trading Act of 1921 unconstitutional under Congress' taxing powers. *Hill v. Wallace*, 259 U.S. 44. Thus, Section 3 had only the limited purpose of placing Congress' futures regulation under the appropriate constitutional authority and since the Commerce Clause reaches all of the listed "agreements" of Section 2(a)(1), the former section is not likely to have been inspiration for the latter.

Second, Section 3 of the 1922 Act did not apply to options not because Congress deemed "involving" too weak a word for the task but because options were already covered by the parts of the 1921 Act not invalidated by *Hill v. Wallace*. In holding the futures part of the 1921 Act unconstitutional under the taxing power, the Supreme Court specifically stated that the options part of the 1921 Act was unaffected. 259 U.S. at 71-72. Although in 1926 the options regulation was held unconstitutional too, *Trusler v. Crooks*, 269 U.S. 475, Congress in 1922 repaired only the damage before it, reenacting the futures regulation under the Commerce Clause and leaving options to be covered by the 1921 Act. See S. Rep. No. 871, 67th Cong., 2d Sess. 1 (1922); *Hearings on H.R. 6772 Before the Senate Committee on Agriculture & Forestry* 223 (1936). The dissent would do better to make hash from old food than old statutes.

The dissent also points out that the old Section 3 was retained in drafting the CEA of 1936 by substituting "commodity" for "grain," and that the text of the old Section is presently in force and codified at 7 U.S.C. § 5. Supposing that we may draw light from 7 U.S.C. § 5 upon Congress' intention regarding the scope of CFTC exclusive jurisdiction (because, as the dissent notes, both use the word "involving"), we find that it supports our conclusion. The introductory, "involving" clause of 7 U.S.C. § 5 limits itself to futures contracts:

> Transactions in commodities involving the sale thereof for future delivery as commonly conducted on boards of trade and known as "futures" are affected with a national public interest;

But the remainder of 7 U.S.C. § 5 details the effects of, purposes for, and problems with a class of commodity trading in-

(Footnote continued on following page)

The Treasury Amendment

The SEC and CBOE make one final argument that the CFTC has no power over GNMA options based upon a clause within Section 2(a)(1) of the CEA, 7 U.S.C. § 2, known as the "Treasury amendment." The Treasury amendment provides that:

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[21] *continued*

struments that would include exchange-formed off-set options as well as futures:

> such transactions are carried on in large volume by the public generally and by persons engaged in the business of buying and selling commodities and the products and byproducts thereof in interstate commerce; the prices involved in such transactions are generally quoted and disseminated throughout the United States and in foreign countries as a basis for determining the prices to the producer and the consumer of commodities and the products and byproducts thereof and to facilitate the movements thereof in interstate commerce; such transactions are utilized by shippers, dealers, millers, and others engaged in handling commodities and the products and byproducts thereof in interstate commerce as a means of hedging themselves against possible loss through fluctuations in price; the transactions and prices of commodities on such boards of trade are susceptible to speculation, manipulation, and control, and sudden or unreasonable fluctuations in the prices thereof frequently occur as a result of such speculation, manipulation, or control, which are detrimental to the producer or the consumer and the persons handling commodities and products and byproducts thereof in interstate commerce, and such fluctuations in prices are an obstruction to and a burden upon interstate commerce in commodities and the products and byproducts thereof and render regulation imperative for the protection of such commerce and the national public interest therein.

Since the exclusive jurisdiction clause unlike 7 U.S.C. § 5 is not specifically limited to "transactions * * * commonly * * * known as 'futures,'" and since it particularly lists "options" among the agreements that may "involve" the futures markets, we conclude that Congress did not limit the exclusive jurisdiction clause to futures by using the word "involving" rather than some synonym such as "relating."

> Nothing in this Act shall be deemed to govern or in any way be applicable to transactions in foreign currency, security warrants, security rights, resales of installment loan contracts, repurchase options, government securities, or mortgages and mortgage purchase commitments, unless such transactions involve the sale thereof for future delivery conducted on a board of trade.

The SEC and CBOE argue that GNMA options come within this list of transactions excluded from CFTC power as either "security rights" or "transactions in * * * government securities." The argument fails. "Security rights" might be characterizable as options to purchase securities ("call" options), but there is no similar exclusion from the CEA for the other half of the CBOE proposal, options to sell securities ("put" options). In fact, Congress refused to adopt that part of the Treasury amendment which would have excluded "puts and calls for securities" from the provisions of the Commodity Exchange Act. See S. Rep. No. 1131, 93d Cong., 2d Sess. 51, reprinted in [1974] U.S. Code Cong. & Ad. News 5843, 5889 (draft of the amendment submitted by the Treasury to the Senate Committee on Agriculture and Forestry).[22] In effect, the SEC and CBOE are asking us to reinsert language in the Treasury amendment that Congress had before it but deleted prior to passage.

Nor are GNMA options "transactions in * * * government securities." "The option transaction is a long step removed from a transaction *in* the commodity involved, since the option purchaser, if he or she does nothing more when the specified date arrives, will simply see the option die." *Commodity Futures Trading Commission v. American Board of Trade*, 473 F.Supp. 1177, 1183 (S.D.N.Y. 1979); see also *Commodity Futures Trading Commission & State of Georgia v. Sterling Capital Co.*, 2 Comm. Fut. L. Rep. (CCH) ¶21,169, at 24,783-24,784 (N.D. Ga.), modified, 2 Comm. Fut. L. Rep. (CCH) ¶21,-

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[22] In the SEA, Congress has been careful to distinguish "security rights" from "puts and calls for securities." See pages 39-41 *infra*.

170 (N.D. Ga. 1981). Only when the option holder exercises the option is there a transaction in a government security. Under the CBOE proposal, however, an option holder never has to exercise the option in order to profit from the position. Thus the options market may exist without any transactions in the commodity itself. Accordingly, the Treasury amendment does not affect CFTC power over GNMA options.

On the other hand, if one of the transactions listed in the Treasury amendment included GNMA options, the "unless" clause would apply. As we have already held, the GNMA options "involve" GNMA futures contracts presently being traded on the various contract markets including the Board of Trade. Thus the Treasury amendment does not affect CFTC jurisdiction over GNMA options.[33] From the legislative history, it is quite clear that the Treasury amendment was adopted by Congress only to prevent dual regulation by the CFTC and bank regulatory agencies of the banks and other sophisticated institutions that ordinarily trade in the enumerated financial instruments. See S. Rep. No. 1131, 93d Cong., 2d Sess. 6, 23, reprinted in [1974] U.S. Code Cong. & Ad. News 5843, 5848, 5863-5864.[34]

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[33] The purpose of the "unless" clause, however, is not to except GNMA options or futures from the Treasury amendment. Rather, the "unless" clause is needed (and was enacted) to except the transactions in security rights, etc. that occur when a futures contract is actually performed or an option is exercised. The futures or options contract is not a transaction in a commodity but insofar as it may presage some future transfer of the commodity, the latter is excepted from the Treasury amendment by the "unless" clause.

[34] For example, the Senate Report stated:

> Likewise, the Committee [Senate Committee on Agriculture & Forestry] believes that regulation by the Commission [CFTC] of transactions in the specified financial instruments (i.e., security warrants, security rights, resales of installment loan contracts, repurchase options, government securities, mortgages and mortgage purchase commitments), which generally are between banks and

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III

Apart from whether GNMA options are within the CFTC's exclusive jurisdiction, we find that the SEC has no power under the SEA to aprove the CBOE's proposed rule changes. Therefore the order under review is void for want of jurisdiction and also for violating the options ban of CEA § 4c(c) and 17 C.F.R. § 32.11[35]

GNMA Options Are Not Securities

The SEC first claims that it has plenary power over the trading of securities on stock exchanges, and that GNMA options are securities. Indeed, SEC power is broad. Section 5 of the SEA, 15 U.S.C. § 78e, makes unlawful any exchange trading in any security unless the exchange has been registered under Section 6, 15 U.S.C. § 78f. Section 6, in turn, gives the SEC power to prescribe rules for exchange registration. Other Sections of the SEA give the SEC various powers to require registration of securities to be traded on particular

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[34] *continued*

other sophisticated institutional participants, is unnecessary, unless executed on a formally organized futures exchange.

S. Rep. No. 1131, 93d Cong., 2d Sess. 23, reprinted in [1974] U.S. Code Cong. & Ad. News 5843, 5863-5864. The dissent also cites legislative history on this point to a different conclusion, S. Rep. No. 850, 95th Cong., 2d Sess. 47, reprinted in [1978] U.S. Code Cong. & Ad. News 2087, 2135, but this is only the text of a letter to the Senate Committee from the Treasury Secretary. We have no grounds to believe that the Senate Committee adopted the opinion of the Treasury Secretary concerning the scope of the Treasury amendment and we doubt that such adoption would be relevant four years after passage of the Treasury amendment. The 1978 amendments to the CEA did not affect the Treasury amendment in any way.

We draw no conclusion as to whether the Treasury amendment affects any CFTC jurisdiction over options on foreign currency, an apparent concern of the *amicus* Philadelphia Stock Exchange.

[35] The options ban applies even if GNMA options are not within CFTC exclusive jurisdiction because if the SEC is without jurisdiction, the SEC savings clause is inapplicable.

exchanges (Section 12, 15 U.S.C. § 78*l*), to prohibit manipulative and deceptive devices (Section 10, 15 U.S.C. § 78j), to regulate brokers and dealers (Section 15, 15 U.S.C. § 78*o*), and to investigate and require public disclosures (Sections 21 and 13, 15 U.S.C. §§ 78u, 78m). Such power, however, is with respect to trading in securities, and the exchange-formed off-set GNMA options that would be traded on the CBOE are not securities.

Section 3(a)(10) of the SEA, 15 U.S.C. § 78c(a)(10), defines "security":

> When used in this title, unless the context otherwise requires—
>
> * * *
>
> (10) The term "security" means any note, stock, treasury stock, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit, for a security, or in general, any instrument commonly known as a "security"; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.

The commodity underlying the proposed options, the GNMA certificate, falls within the definition of "security," being a "note, * * * bond, [or] debenture" with a maturity exceeding nine months. See *Davidson v. Dean Witter Reynolds, Inc.*, 478 F. Supp. 494, 495 (D. Colo. 1979) (anti-fraud provisions of SEA are applicable to GNMA's); but see *Marine Bank v. Weaver*, 50 U.S.L.W. 4285 (March 8, 1982) (certificates of deposit issued by FDIC-insured bank are not securities for anti-fraud pur-

poses). Exchange-formed off-set options, however, are not within the definition.[38]

The SEC argues that the proposed options are "warrants or rights to subscribe to or purchase" the GNMA's. Warrants and rights are distinguishable from the proposed options, however. Ordinarily, warrants or rights are issued in connection with a transaction in which there is a genuine probability that the subscriber or purchaser will exercise the option because of a special interest in the underlying security itself. In the proposed market for GNMA options, on the other hand, the interest more often would be in the price of the underlying security and the identity of the security would be secondary. "The usual 'warrant' is 'issued with bonds and shares of stock,'" for example, in connection with a corporate reorganization or merger, or as an incentive to employees of the company whose stock underlies the warrant. *Miller v. General Outdoor Advertising Co.*, 223 F. Supp. 790, 794 (S.D.N.Y. 1963) (quoting 1 Dewing, The Financial Policy of Corporations 265 (5th ed.)), reversed on other grounds, 337 F.2d 994 (2d Cir. 1964). "The 'right to subscribe' properly refers to the right given by an issuer to its stockholders to buy additional stock; if the corporation is to issue new stock often these rights are required by law to be given to the old stockholders because they have preemptive rights to the new stock." *Id.*

> "[P]uts" and "calls" are in a different category from "warrants" and "rights," although all are forms of options. * * * [The former] instruments are generally written in bearer form by more or less professional investors, endorsed by stock exchange houses, and then bought and sold in the market. * * * The[ ] option dealers rarely write the options themselves. * * * [The put and call options'] economic *raison d'être* is to serve as insurance against future market movements. For example, a person who is long may purchase a put as insurance

[38] Our holding that GNMA options are not securities does not depend on whether the GNMA's themselves are securities, although we shall assume without deciding that GNMA's are securities.

> that he will be able to sell if the market falls to a certain level, and a person who is short may purchase a call to ensure that he will be able to cover (buy) if the market rises to a certain figure. At the same time, these instruments provide a cheap form of speculation. Since they have served as manipulative devices in the past, the Commission [SEC] was given authority in the Securities Exchange Act of 1934 * * * to regulate puts and calls by rule. [citing § 9(b)-(d) * * *.]

I L. Loss, Securities Regulation 467-468 (2d ed. 1961). In contrast to put and call options, warrants and rights generally have the more limited economic function of facilitating actual transfers of particular securities.[37]

When Congress wrote "warrant or right to subscribe to or purchase" a security, it did not intend to include the exchange-formed off-set options that the CBOE would trade here. Congress knew what security options

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[37] In a 1973 rule-making and its current Rule 12a-6, the SEC made a similar distinction between put and call options and warrants or rights. Rule 12a-6(a)(1), 17 C.F.R. § 240.12a-6(a)(1), provides:

> The term "option" shall include any put, call, spread, straddle, or other option or privilege of buying a security from or selling a security to another without being bound to do so, but such term shall not include any such option where the writer is: the issuer of the security which may be purchased or sold upon exercise of the option, or is a person that directly, or indirectly, through one or more intermediaries, controls, or is controlled by, or is under common control with such issuer.

As the SEC explained, "The definition of 'option' for the purposes of this rule has been revised to make clear that the rule does not apply to ordinary warrants, rights and convertible securities." SEA Release No. 10128, 38 Fed. Reg. 11448, 11449 (May 8, 1973). The exclusionary language in the Rule defining "ordinary warrants, rights and convertible securities" is essentially equivalent to our definition in the text, and clearly would not cover the proposed GNMA options since they would be "written" by the CBOE's clearing house rather than by the mortgage bankers who issue the underlying GNMA's.

were[35] but did not see fit to include them in its listing as separate securities.

Moreover, "warrants or rights" would cover only options to purchase ("call" options) and the CBOE off-set program requires the complementary trading of options to sell ("put" options). The SEC argues that the broad definitions of "purchase" and "sale" of a security under Sections 3(a)(13) and 3(a)(14) of the SEA, 15 U.S.C. §§ 78c(a)(13) and 78c(a)(14), remedy the disparity between puts and calls. But even supposing that call options are securities, no reasonable combination of buying or selling them turns the deal into the transfer of a put option. *Cf. Marine Bank v. Weaver*, 50 U.S.L.W. 4285, 4286 n.2, 4287 n.9 (Supreme Court, March 8, 1982) (although "a pledge of stock is equivalent to a sale for the purposes of the antifraud provisions of the Federal securities laws," argument rejected that a "certificate of deposit [deemed not a security by itself] was somehow transformed into a security when it was pledged"). Although the transfer of an option may be deemed a purchase or sale for some purposes, *e.g., Bershad v. McDonough*, 428 F.2d 693 (7th Cir. 1970), it is always the purchase or sale of the underlying security, not a purchase or sale of the option *qua* security. Thus we are in agreement with the Supreme Court's statement in *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 750-751, that option holders "have been recognized as 'purchasers' or 'sellers' of securities for purposes of Rule 10b-5 * * *." *Blue Chip Stamps* stands for the proposition that § 10(b) of the SEA and Rule 10b-5 may be invoked only by purchasers or sellers of securities, and says nothing about the purchase or sale of security options except insofar as options may facilitate purchase or sale of the underlying security.[36]

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[35] See SEA § 9, 15 U.S.C. § 78i (entitled "Manipulation of Security Prices"). In particular, Section 9(d), 15 U.S.C. § 78i(d), distinguishes options from warrants and rights: "The terms 'put', 'call', 'straddle', 'option', or 'privilege' as used in this section shall not include any registered warrant, right, or convertible security."

[36] Therefore, *Mansbach v. Prescott, Ball & Turben*, 598 F.2d 1017, 1026 n. 40 (6th Cir. 1979), cited by the SEC and CBOE,

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The SEC and CBOE also argue that the GNMA options are "investment contracts" or interests "commonly known as a security." Their authority for this proposition is I L. Loss, Securities Regulation 469 (2d ed. 1961), which speculates with regard to whether options should be deemed securities for purposes of registration under the Securities Act of 1933 and the "insider" trading restrictions of SEA § 16: "both [puts and calls] are such an integral part of securities trading that it seems entirely reasonable to subsume them under the phrases 'investment contract' and 'interest or instrument commonly known as a "security."'" But GNMA's are "exempted securities" under both the Securities Act of 1933[40] and the SEA,[41] and therefore need not be registered under the former Act[42] nor are subject to the insider rules of SEA § 16.[43] Accordingly, the purposes to be served by Professor Loss' analysis are inapplicable to the underlying GNMA's, and he suggests no reason for treating options on GNMA's any differently.

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[39] *continued*

incorrectly reads *Blue Chip Stamps* as holding that options are securities. We of course have no occasion to question the holding in *Mansbach* that there may be liability under Rule 10b-5 for manipulative stock option transactions. On the other hand, *Lutgert v. Vanderbilt Bank*, 508 F.2d 1035, 1038 (5th Cir. 1975), cited by the SEC, involved subscription rights to purchase a security that we would agree come within the definition of a security.

[40] GNMA's are securities "guaranteed by the United States * * * or [issued or guaranteed] by any person controlled or supervised by and acting as an instrumentality of the Government of the United States pursuant to authority granted by the Congress of the United States * * *." Section 3(a)(2) of the Securities Act of 1933, 15 U.S.C. § 77c(a)(2).

[41] GNMA's are "securities which are * * * obligations guaranteed as to principal or interest by[ ] the United States * * * [and] securities issued or guaranteed by corporations in which the United States has a direct or indirect interest * * *." SEA § 3(a)(12), 15 U.S.C. § 78c(a)(12).

[42] See Sections 3(a)(2) and 5(a) of the Securities Act of 1933, 15 U.S.C. §§ 77c(a)(2), 77e(a).

[43] See SEA § 16(a), (b) and (c), 15 U.S.C. § 78p(a), (b) and (c).

> For purposes of this case, we need not distinguish between an "investment contract" and an "instrument commonly known as a 'security.'" In either case, the basic test for distinguishing the transaction from other commercial dealings is
>
> > "whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others." [*SEC v. W.J.*] *Howey*, 328 U.S. [293,] 301.
>
> This test, in shorthand form, embodies the essential attributes that run through all of the Court's decisions defining a security. The touchstone is the presence of an investment in a common venture premised on a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others.

United Housing Foundation, Inc. v. Forman, 421 U.S. 837, 852 (footnote omitted) (holding that shares of stock in a cooperative apartment house are not "securities" within Securities Acts). Courts have consistently held that commodity futures are not "investment contract" securities. *E.g., Milnarik v. M-S Commodities, Inc.*, 457 F.2d 274, 275 n.1 (7th Cir. 1972) (per then Circuit Judge Stevens), certiorari denied, 409 U.S. 887; *McCurnin v. Kohlmeyer & Co.*, 340 F. Supp. 1338, 1341 (E.D. La. 1972), affirmed *per curiam*, 477 F.2d 113 (5th Cir. 1973); *American Grain Ass'n v. Canfield, Burch & Mancuso*, Civ. No. 790391 (W.D. La. Feb. 1, 1982); Saitlin, *Exclusive CFTC Jurisdiction of Commodity Trading Vehicles May Depend Upon Form Over Substance*, 33 Bus. Law. 241, 241-242 (1977); Bromberg, *Commodities Law and Securities Law—Overlaps and Preemptions*, 1 J. Corp. L. 217, 243-245 (1976). Judge Higginbotham of the Northern District of Texas held recently that a "standby commitment" to take delivery of GNMA's—essentially a put option in GNMA's between two commercial GNMA traders[44]—is not an "investment contract" either. *LTV Federal Credit Union v. UMIC*

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[44] The parties to the standby commitment presumably came within the trade exemption to the options ban. CEA § 4c(c), 15 U.S.C. § 6c(c); 17 C.F.R. § 32.4(a).

Government Securities, Inc., 523 F. Supp. 819, 828-833 (N.D. Tex. 1981). Judge Higginbotham stated:

> This court here sees no functional distinction between the Standby Commitment and commodity contracts for future delivery, as regarding their possible status as "investment contracts," that would justify a different holding here. The economic realities of this transaction are that there is no "common enterprise"—no common business venture from which both parties can hope to generate profits to be distributed among them. And even if there were a "common enterprise," the profits each party can hope to derive, are derived solely from the movement of a market over which neither has control or the ability to influence. The Standby Commitment thus is not an "investment contract" within the meaning of the Securities Act or the Exchange Act.

Id. at 830. Exactly the same analysis applies to the GNMA options program proposed here.

SEC v. G. Weeks Securities, Inc., 483 F. Supp. 1239 (W.D. Tenn. 1980), cited by the SEC, is not to the contrary. The transaction in *Weeks*, known as a "standby with pair-off," involved only a "book" transfer of GNMA's used to camouflage a loan from investor to issuer. See 483 F. Supp. at 1242 (hypothetical example explaining in steps how the "standby with pair-off" works). In substance, the investor would receive a stated amount of "interest" (plus some possibility of extra gain due to fluctuation in the price of GNMA's) in return for use of his funds, while taking the risk that the issuer might be unable to invest the loans profitably enough to meet the "interest" payments. The district court quite reasonably held this transaction to be both an "investment contract" and an "evidence of indebtedness" within the definition of security. *Cf. Glazer v. National Commodity Research & Statistical Service, Inc.*, 547 F.2d 392, 393 (7th Cir. 1977) (rejecting SEC argument that options to buy or sell commodity futures are "investment contracts,"

"interests commonly known as securities," or "evidence of indebtedness").[45]

The Context Requires That GNMA Options Are Not Securities

Section 3(a) of the SEA, 15 U.S.C. § 78c(a), states that the meaning of "security" will not be frozen in the terms of the listed transactions when "the context otherwise requires." Similarly, the Supreme Court has cautioned that "a 'literal approach' to defining a security is misplaced." *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 849. Rather, "one must apply a test in terms of the purposes of the Federal Acts * * *." *Teamsters v. Daniel*, 439 U.S. 551, 559 (quoting *SEC v. Variable Annuity Life Ins. Co.*, 359 U.S. 65, 80 (Brennan, J., concurring)).

In *Daniel*, the Supreme Court considered the existence of an alternative, comprehensive regulatory framework relevant to how "security" should be construed. The Supreme Court held in effect that the Employment Retirement Income Security Act of 1974 (ERISA) preempted the application of the Securities Acts to certain pension plans. 439 U.S. at 557, 569-570. "The existence of this comprehensive legislation governing the use and terms of employee pension plans severely undercuts all arguments for extending the Securities Acts to noncontributory, compulsory pension plans. Congress believed that it was filling a regulatory void when it enacted ERISA, * * * [and] in light of ERISA[, applica-

[45] The dissent suggests that Rule 3a11-1, 17 C.F.R. § 240.3a11-1, supports options being securities. We disagree. Rule 3a11-1 defines "equity security" to include "any put, call, straddle, or other option or privilege of buying such a[n equity] security." But "equity security" is defined in SEA § 3(a)(11), 15 U.S.C. § 78c(a)(11), to mean (unless the context otherwise requires) "any stock or similar security * * *." This definition is used, for example, by the Williams Act, 15 U.S.C. §§ 78m(d)-(e), 78n(d)-(f), which regulates tender offers and large purchases of stock that may affect control of the corresponding corporation. GNMA's are not corporate stocks, and hence are not "equity securities." See also pages 27, 42 *supra*. Thus Rule 3a11-1 has nothing to do with GNMA options.

tion of the Securities Acts] serves no general purpose." *Id.* at 569-570. See also *Marine Bank v. Weaver*, 50 U.S.L.W. 4285, 4287 (Supreme Court, March 8, 1982) (even though a six-year bank certificate of deposit would appear to be a "note * * * [or] bond" within the statutory definition, comprehensive banking regulation and FDIC insurance "otherwise required" that it not be deemed a security).

In the same fashion here, the CEA and the CFTC's consistent regulation of GNMA futures have displaced any prior SEC authority over GNMA options. CFTC authority to regulate commodity options under CEA §§ 4c(b) and 4c(c) is plenary; there is no need for compounding the regulation by adding the SEC. In enacting the CEA, Congress believed it was filling a regulatory void, see, *e.g.*, 120 Cong. Rec. 34736-34737 (1974) (remarks of Rep. Poage), and it intended the agencies' powers to be non-redundant, as is apparent from the complementary CFTC exclusive jurisdiction and SEC savings clauses in CEA § 2(a)(1), 7 U.S.C. § 2, and the legislative history. See, *e.g.*, S. Rep. No. 850, 95th Cong., 2d Sess. 22, reprinted in [1978] U.S. Code Cong. & Ad. News 2087, 2110 ("the basic conclusion reached in 1974 that there should be a single regulatory agency responsible for futures trading is as valid now as it was then"). Consequently, "security" should be construed to exclude GNMA options in order to avoid duplicative regulation over them by the SEC.

SEC Power Under Section Nine of the SEA

Another potential source of SEC power over options, SEA § 9, 15 U.S.C. § 78i, does not depend on the options being securities. Section 9(b), in particular, gives the SEC power to regulate exchange trading of "any put, call, straddle, or other option." Since Section 9(f) withdraws SEC authority regarding options on exempted securities,[46] however, the SEC has no power to permit trading of GNMA options.

[46] Section 9(f), 15 U.S.C. § 78i(f), provides: "The provisions of this section shall not apply to an exempted security." GNMA's are exempted securities under Section 3(a)(12), 15 U.S.C. § 78c(a)(12).

That authority over options is specifically granted under Section 9 is further evidence that the SEC lacks authority over options under other sections of the SEA. Indeed, the SEC consistently has relied upon Section 9 for its authority to regulate exchange-traded options. For example, in 1961, in its study on puts and calls, the SEC stated that its authority over such transactions came from Sections 9(b) and 9(c). SEC Division of Trading & Exchanges, Report on Put and Call Options 1 (1961); 17th Annual Report of the SEC 67 (1961). In 1973, when it first authorized the CBOE stock options market, the SEC relied on its authority under Sections 9(b) and 9(c) to permit stock options trading through promulgation of Rule 9b-1. SEA Release No. 9930, 38 Fed. Reg. 1646 (Jan. 17, 1973); SEA Release No. 10552, 38 Fed. Reg. 34665 (Dec. 17, 1973). In 1975, following Congress' 1975 amendments to the SEA, the SEC rescinded Rule 9b-1 and adopted the more general Rule 19b-4. Nevertheless, in the SEC's view, "the 1975 Amendments have not affected the Commission's authority under Section 9 of the Act," and "the Commission will, of course, continue to review option trading closely in light of its broad authority under Section 9 of the Act." SEA Release No. 11604, 40 Fed. Reg. 40509, 40511 (Sept. 3, 1975). Finally, as recently as 1980, the SEC stated: "Pursuant to Section 9(b) of the Securities Exchange Act of 1934 ('Act'), the Commission has been granted plenary authority to regulate all aspects of options trading on exchanges * * *." SEA Release No. 16701, 45 Fed. Reg. 21426 (April 1, 1980).

In enacting the SEA, Congress viewed security options not as securities themselves, but as dangerous mechanisms used primarily for manipulating the prices of the underlying securities. See S. Rep. No. 1455, 73d Cong., 2d Sess. 37-39, 45-47, 51-52 (1934); S. Rep. No. 792, 73d Cong., 2d Sess. 9 (1934); H.R. Rep. No. 1383, 73d Cong., 2d Sess. 10-11 (1934). Congress also recognized that there would be less potential for manipulation with respect to exempted securities, since they are issued or guaranteed by the Government. See *Stock Exchange Regulation: Hearings on H.R. 7852 and H.R. 8720 Before the House Committee on Interstate and Foreign Commerce*, 73d Cong., 2d Sess. 818-820 (1934); *Federal*

Securities Act: Hearings on H.R. 4314 Before the House Committee on Interstate and Foreign Commerce, 73d Cong., 1st Sess. 110 (1933).[47] Accordingly, by Section 9(f), Congress removed SEC power over options on exempted securities because their regulation was unnecessary. Thus the forty-year history of securities and commodities legislation can be construed sensibly by recognizing that the "guaranteed" value of exempted securities makes them closer in nature to traditional commodities, such as corn or pork bellies, than to traditional corporate stocks.[48] In 1934, there was no need for the SEC to monitor options on exempted securities such as GNMA's; in 1974, when the need arose for commodity option regulation generally, Congress endowed the CFTC with the necessary authority.

Other Sources of Options Power

The SEC purported to approve the CBOE rule changes pursuant to SEA § 19(b)(1), 15 U.S.C. § 78s(b)(1), and Rule 19b-4 thereunder. SEA Release No. 17577 (Feb. 26, 1981). Section 19(b)(1) simply provides that exchanges may file rule changes with the SEC and that with exceptions, rule changes become effective upon SEC approval. Section 19(b)(2), 15 U.S.C. § 78s(b)(2), states in part that the SEC "shall approve a proposed rule change of a self-regulatory organization if it finds that such proposed rule change is consistent with the requirements of this title * * *." Thus neither Section 19(b)(1) nor Section 19(b)(2) expands SEC jurisdiction with respect to rule changes beyond what has already been granted elsewhere in the SEA;

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[47] In 1936, Congress thought exempted securities safe enough to be included among the instruments in which a futures commission merchant could invest his customers' margin accounts. CEA of 1936, § 4d(2). In its 1968 amendments to the CEA, Congress reaffirmed the soundness of exempted securities by retaining them as margin account investments while dropping others. Pub. L. No. 90-258, § 6, 82 Stat. 27 (1968).

[48] See S. Rep. No. 850, 95th Cong., 2d Sess. 13, reprinted in [1978] U.S. Code Cong. & Ad. News 2087, 2101; *LTV Federal Credit Union v. UMIC Government Securities, Inc.*, 523 F. Supp. 819, 832 (N.D. Tex. 1981).

otherwise, the rule changes would not be "consistent with the requirements of this title."

Section 23(a)(1), 15 U.S.C. § 78w(a)(1), which allows the SEC to promulgate "such rules and regulations as may be necessary or appropriate to implement the provisions of this title," does not reach GNMA options either. Assuming that Section 23(a)(1) can ever enlarge SEC jurisdiction, we find it inapplicable here. It is unnecessary for the SEC to promulgate rules regarding GNMA options when the CFTC has the necessary statutory jurisdiction[49] and inappropriate in the face of the Congressional options ban of CEA § 4c(c). Our upholding the jurisdiction of the CFTC will not foreclose the CBOE from instituting a program of options on GNMA's once the CFTC promulgates appropriate rules and the options ban is lifted through a proper submission to and approval by Congress.

As already mentioned, pages 25-26 *supra*, Congress was given at least two opportunities since passage of the Commodity Futures Trading Commission Act of 1974 to adjust SEC jurisdiction, but each time Congress chose to make no adjustments. This Court would be remiss to do differently. The SEC simply is without power to authorize trading in GNMA options.

IV

The statutes at issue in this case are complex enough to admit different opinions of their proper construction.

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[49] In its proposed Rule 34.1 the CFTC would disown its jurisdiction over GNMA options, arguably making SEC jurisdiction over them "necessary." See note 12 *supra*. This attempt to redraw the statutory lines of jurisdiction would seem ineffective in the absence of new legislation, but we do not decide the question because Rule 34.1 has not yet been adopted. See note 8 *supra*. The dissent suggests a similar argument, that because the CFTC "has neither the expertise nor the desire to regulate the trading of GNMA options," we are "otherwise required" to deem them securities. Dissent p. 93. But surely Congress did not intend us to play "finders keepers" with the CFTC's unexercised jurisdiction. Rather, while we wait for the CFTC to follow the procedures set out in CEA § 4c(c), GNMA options are to be *banned*.

The dissent, however, has shown itself to be motivated by more "practical" matters such as whether the CFTC is healthy enough to handle its statutory jurisdiction. Indeed the dissent notes that the CFTC has been criticized in testimony before Congress as unfit to regulate and that Congress may soon be legislating anew. That Congress presently is reconsidering the two agencies' jurisdictions, however, means there is less need for "judicial first-aid" and a greater need for telling Congress the plain meaning of the laws now in force.

Our disposition of this case is based upon statutory construction and legislative history. Our task should not reflect a value judgment as to which of the competing agencies is best equipped to regulate these options. If Congress disagrees with our interpretation it can of course amend the applicable statutes. To approve the SEC's order of February 28, 1981, would be contrary to the present Congressional scheme giving the CFTC exclusive jurisdiction over GNMA options trading while giving no authority over such trading to the SEC. Therefore, the SEC order of February 28, 1981, is set aside and our prior stay is dissolved.[50] Our mandate shall issue forthwith, with costs to be taxed to respondents.

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[50] We note that our opinion in this case is limited to the particular issue presented. This opinion is not intended to decide related questions, such as whether SEC anti-fraud rules may apply to commodity options transactions, whether the Federal Reserve Board may set margin requirements for options on exempted securities, to what extent CFTC jurisdiction may preempt state enforcement activity, and what responsibilities the Securities Investor Protection Corporation may have regarding GNMA options.

APPENDIX

CEA § 2(a)(1), 7 U.S.C. § 2:

Definitions

For the purposes of this chapter "contract of sale" shall be held to include sales, agreements of sale, and agreements to sell. The word "person" shall be construed to import the plural or singular, and shall include individuals, associations, partnerships, corporations, and trusts. The word "commodity" shall mean wheat, cotton, rice, corn, oats, barley, rye, flaxseed, grain sorghums, mill feeds, butter, eggs, Solanum tuberosum (Irish potatoes), wool, wool tops, fats and oils (including lard, tallow, cottonseed oil, peanut oil, soybean oil and all other fats and oils), cottonseed meal, cottonseed, peanuts, soybeans, soybean meal, livestock, livestock products, and frozen concentrated orange juice, and all other goods and articles, except onions as provided in section 13-1 of this title, and all services, rights, and interests in which contracts for future delivery are presently or in the future dealt in: *Provided*, That the Commission shall have exclusive jurisdiction with respect to accounts, agreements (including any transaction which is of the character of, or is commonly known to the trade as, an "option", "privilege", "indemnity", "bid", "offer", "put", "call", "advance guaranty", or "decline guaranty"), and transactions involving contracts of sale of a commodity for future delivery, traded or executed on a contract market designated pursuant to section 7 of this title or any other board of trade, exchange, or market, and transactions subject to regulation by the Commission pursuant to section 23 of this title: *And provided further*, That, except as hereinabove provided, nothing contained in this section shall (i) supersede or limit the jurisdiction at any time conferred on the Securities and Exchange Commission or other regulatory authorities under the laws of the United States or of any State, or (ii) restrict the Securities and Exchange Commission and such other authorities from carrying out their duties

and responsibilities in accordance with such laws. Nothing in this section shall supersede or limit the jurisdiction conferred on courts of the United States or any State. Nothing in this chapter shall be deemed to govern or in any way be applicable to transactions in foreign currency, security warrants, security rights, resales of installment loan contracts, repurchase options, government securities, or mortgages and mortgage purchase commitments, unless such transactions involve the sale thereof for future delivery conducted on a board of trade.

* * * * *

CEA § 2(a)(8)(B), 7 U.S.C. § 4a(g)(2):

(i) The Commission shall maintain communications with the Department of the Treasury, the Board of Governors of the Federal Reserve System, and the Securities and Exchange Commission for the purpose of keeping such agencies fully informed of Commission activities that relate to the responsibilities of those agencies, for the purpose of seeking the views of those agencies on such activities, and for considering the relationships between the volume and nature of investment and trading in contracts of sale of a commodity for future delivery and in securities and financial instruments under the jurisdiction of such agencies.

(ii) When a board of trade applies for designation as a contract market involving transactions for future delivery of any security issued or guaranteed by the United States or any agency thereof, the Commission shall promptly deliver a copy of such application to the Department of the Treasury and the Board of Governors of the Federal Reserve System. The Commission may not designate a board of trade as a contract market based on such application until forty-five days after the date the Commission delivers the application to such agencies or until the Commission receives comments from each of such agencies on the application, whichever period is shorter. Any comments

received by the Commission from such agencies shall be included as part of the public record of the Commission's designation proceeding. In designating, or refusing, suspending, or revoking the designation of, a board of trade as a contract market involving transactions for future delivery referred to in this clause or in considering possible emergency action under section 12a(9) of this title with respect to such transactions, the Commission shall take into consideration all comments it receives from the Department of the Treasury and the Board of Governors of the Federal Reserve System and shall consider the effect that any such designation, suspension, revocation, or emergency action may have on the debt financing requirements of the United States Government and the continued efficiency and integrity of the underlying market for government securities.

(iii) The provisions of this paragraph shall not create any rights, liabilities, or obligations upon which actions may be brought against the Commission.

CEA § 4c, 7 U.S.C. § 6c:

Prohibited transactions

Commodities specifically listed

(a) It shall be unlawful for any person to offer to enter into, enter into, or confirm the execution of, any transaction involving any commodity, which is or may be used for (1) hedging any transaction in interstate commerce in such commodity or the products or by-products thereof, or (2) determining the price basis of any such transaction in interstate commerce in such commodity, or (3) delivering any such commodity sold, shipped, or received in interstate commerce for the fulfillment thereof—

(A) if such transaction is, is of the character of, or is commonly known to the trade as, a "wash sale," "cross trade," or "accommodation trade," or is a fictitious sale;

(B) if such transaction involves any commodity specifically set forth in section 2 of this title, prior to October 23, 1974, and if such transaction is of the character of, or is commonly known to the trade as, an "option", "privilege", "indemnity", "bid", "offer", "put", "call", "advance guaranty", or "decline guaranty", or

(C) if such transaction is used to cause any price to be reported, registered or recorded which is not a true and bona fide price.

Nothing in this section shall be construed to prevent the exchange of futures in connection with cash commodity transactions or of futures for cash commodities, or of transfer trades or office trades if made in accordance with board of trade rules applying to such transactions and such rules shall have been approved by the Commission.

Commodities regulated but not specifically listed

(b) No person shall offer to enter into, enter into, or confirm the execution of, any transaction subject to the provisions of subsection (a) of this section involving any commodity regulated under this chapter, but not specifically set forth in section 2 of this title, prior to October 23, 1974, which is of the character of, or is commonly known to the trade as, an "option", "privilege", "indemnity", "bid", "offer", "put", "call", "advance guaranty", or "decline guaranty", contrary to any rule, regulation, or order of the Commission prohibiting any such transaction or allowing any such transaction under such terms and conditions as the Commission shall prescribe within one year after the effective date of the Commodity Futures Trading Commission Act of 1974 unless the Commission determines and notifies the Senate Committee on Agriculture, Nutrition, and Forestry and the House Committee on Agriculture that it is unable to prescribe such terms and conditions within such period of time: *Provided*, That any such order, rule, or regulation may be made only after notice and opportunity for hearing:

And provided further, That the Commission may set different terms and conditions for different markets.

Commodity option transaction; conditions ending prohibition; excepted persons

(c) Notwithstanding the provisions of subsection (b) of this section, no person may, after September 30, 1978, offer to enter into, enter into, or confirm the execution of any commodity option transaction involving any commodity regulated under this chapter but not specifically set forth in section 2 of this title prior to October 23, 1974, until (1) the Commission transmits to the House Committee on Agriculture and the Senate Committee on Agriculture, Nutrition, and Forestry documentation of its ability to regulate successfully such transactions, including a copy of the Commission's proposed rules and regulations, and (2) the expiration of thirty calendar days of continuous session of Congress after the date of such transmittal. The Commission is not precluded from transmitting, at any time, documentation relating to its ability to regulate such transactions regarding individual commodities, classes of commodities, or regulation of such transactions on specific boards of trade. Nothing in this subsection shall affect any rights or obligations arising out of any transactions subject to the provisions of this subsection entered into, or the execution of which was confirmed, prior to October 1, 1978: *Provided*, That this prohibition shall not apply to any transaction expressly permitted under rules or regulations prescribed by the Commission, before or after September 30, 1978, to be offered to be entered into, entered into, or confirmed, in which the purchaser is a producer, processor, commercial user of, or a merchant handling, the commodity involved in the transaction, or the products or by-products thereof.

* * * * *

SEA § 3(a), 15 U.S.C. § 78c(a):

Definitions and application

Definitions

When used in this chapter, unless the context otherwise requires—

* * * * *

(10) The term "security" means any note, stock, treasury stock, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit, for a security, or in general, any instrument commonly known as a "security"; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.

* * * * *

(12) The term "exempted security" or "exempted securities" includes securities which are direct obligations of, or obligations guaranteed as to principal or interest by, the United States; such securities issued or guaranteed by corporations in which the United States has a direct or indirect interest as shall be designated for exemption by the Secretary of the Treasury as necessary or appropriate in the public interest or for the protection of investors; municipal securities, as defined in paragraph (29) of this subsection: *Provided, however*, That municipal securities shall not be deemed to be "exempted securities" for purposes of sections 78*o*, 78*o*-3 (except subsections (b)(6), (b)(11), and (g)(2) thereof),

and 78q-1 of this title; any interest or participation in any common trust fund or similar fund maintained by a bank exclusively for the collective investment and reinvestment of assets contributed thereto by such bank in its capacity as trustee, executor, administrator, or guardian; any interest or participation in a single trust fund, or a collective trust fund maintained by a bank, or any security arising out of a contract issued by an insurance company, which interest, participation, or security is issued in connection with (A) a stock bonus, pension, or profit-sharing plan which meets the requirements for qualification under section 401 of Title 26, (B) an annuity plan which meets the requirements for the deduction of the employer's contribution under section 404(a)(2) of Title 26, or (C) a governmental plan as defined in section 414(d) of Title 26 which has been established by an employer for the exclusive benefit of its employees or their beneficiaries for the purpose of distributing to such employees or their beneficiaries the corpus and income of the funds accumulated under such plan, if under such plan it is impossible, prior to the satisfaction of all liabilities with respect to such employees and their beneficiaries, for any part of the corpus or income to be used for, or diverted to, purposes other than the exclusive benefit of such employees or their beneficiaries, other than any plan described in clause (A), (B), or (C) of this paragraph (i) which covers employees some or all of whom are employees within the meaning of section 401(c) of Title 26, or (ii) which is a plan funded by an annuity contract described in section 403(b) of Title 26; and such other securities (which may include, among others, unregistered securities, the market in which is predominantly intrastate) as the Commission may, by such rules and regulations as it deems consistent with the public interest and the protection of investors, either unconditionally or upon specified terms and conditions or for stated periods, exempt from the operation of any one or more provisions of this chapter which by their terms do not apply to an "exempted security" or to "exempted securities".

(13) The terms "buy" and "purchase" each include any contract to buy, purchase, or otherwise acquire.

(14) The terms "sale" and "sell" each include any contract to sell or otherwise dispose of.

SEA § 9, 15 U.S.C. § 78i:

Manipulation of security prices

* * * *

Transactions relating to puts, calls, straddles, or options

(b) It shall be unlawful for any person to effect, by use of any facility of a national securities exchange, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors—

(1) any transaction in connection with any security whereby any party to such transaction acquires any put, call, straddle, or other option or privilege of buying the security from or selling the security to another without being bound to do so; or

(2) any transaction in connection with any security with relation to which he has, directly or indirectly, any interest in any such put, call, straddle, option, or privilege; or

(3) any transaction in any security for the account of any person who he has reason to believe has, and who actually has, directly or indirectly, any interest in any such put, call, straddle, option, or privilege with relation to such security.

Endorsement or guarantee of puts, calls, straddles, or options

(c) It shall be unlawful for any member of a national securities exchange directly or indirectly to endorse or guarantee the performance of any put, call, straddle, option, or privilege in relation to any

security registered on a national securities exchange, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Registered warrant, right, or convertible security not included in "put", "call", "straddle", or "option"

(d) The terms "put", "call", "straddle", "option", or "privilege" as used in this section shall not include any registered warrant, right, or convertible security.

* * * * *

Section not applicable to exempted securities

(f) The provisions of this section shall not apply to an exempted security.

SEA § 19(b), 15 U.S.C. § 78s(b):

Proposed rule changes; notice; proceedings

(b)(1) Each self-regulatory organization shall file with the Commission, in accordance with such rules as the Commission may prescribe, copies of any proposed rule or any proposed change in, addition to, or deletion from the rules of such self-regulatory organization (hereinafter in this subsection collectively referred to as a "proposed rule change") accompanied by a concise general statement of the basis and purpose of such proposed rule change. The Commission shall, upon the filing of any proposed rule change, publish notice thereof together with the terms of substance of the proposed rule change or a description of the subjects and issues involved. The Commission shall give interested persons an opportunity to submit written data, views, and arguments concerning such proposed rule change. No proposed rule change shall take effect unless approved by the Commission or otherwise permitted in accordance with the provisions of this subsection.

(2) Within thirty-five days of the date of publication of notice of the filing of a proposed rule change in accordance with paragraph (1) of this subsection, or within such longer period as the Commission may designate up to ninety days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or as to which the self-regulatory organization consents, the Commission shall—

(A) by order approve such proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved. Such proceedings shall include notice of the grounds for disapproval under consideration and opportunity for hearing and be concluded within one hundred eighty days of the date of publication of notice of the filing of the proposed rule change. At the conclusion of such proceedings the Commission, by order, shall approve or disapprove such proposed rule change. The Commission may extend the time for conclusion of such proceedings for up to sixty days if it finds good cause for such extension and publishes its reasons for so finding or for such longer period as to which the self-regulatory organization consents.

The Commission shall approve a proposed rule change of a self-regulatory organization if it finds that such proposed rule change is consistent with the requirements of this chapter and the rules and regulations thereunder applicable to such organization. The Commission shall disapprove a proposed rule change of a self-regulatory organization if it does not make such finding. The Commission shall not approve any proposed rule change prior to the thirtieth day after the date of publication of notice of the filing thereof, unless the Commission finds good cause for so doing and publishes its reasons for so finding.

* * * * *

SEA § 23(a)(1), 15 U.S.C. § 78w(a)(1):

Rules, regulations, and orders; annual reports

Power to make rules and regulations; considerations; public disclosure

(a)(1) The Commission, the Board of Governors of the Federal Reserve System, and the other agencies enumerated in section 78c(a)(34) of this title shall each have power to make such rules and regulations as may be necessary or appropriate to implement the provisions of this chapter for which they are responsible or for the execution of the functions vested in them by this chapter, and may for such purposes classify persons, securities, transactions, statements, applications, reports, and other matters within their respective jurisdictions, and prescribe greater, lesser, or different requirements for different classes thereof. No provision of this chapter imposing any liability shall apply to any act done or omitted in good faith in conformity with a rule, regulation, or order of the Commission, the Board of Governors of the Federal Reserve System, other agency enumerated in section 78c(a)(34) of this title, any self-regulatory organization, notwithstanding that such rule, regulation, or order may thereafter be amended or rescinded or determined by judicial or other authority to be invalid for any reason.

17 C.F.R. § 32.11:

Suspension of commodity option transactions.

(a) Notwithstanding any other provision of this Part 32, it shall be unlawful on and after June 1, 1978, until further rule, regulation or order of the Commission, for any person to solicit or accept orders for, or to accept money, securities or property in connection with, the purchase or sale of any commodity option, or to supervise any person or persons so engaged.

(b) The provisions of paragraph (a) of this section shall not apply to any commodity option

offered or entered into in accordance with the provisions of § 32.4(a).

(c) Nothing in this section shall apply to, or affect the rights, privileges or obligations of any person arising out of any commodity option transaction entered into prior to June 1, 1978.

CFTC's new § 33.4 (to be codified at 17 C.F.R. § 33.4):

Designation as a contract market for the trading of commodity options.

The Commission may designate any board of trade located in the United States as a contract market for the trading of options on contracts of sale for future delivery * * *.

17 C.F.R. § 32.2:

Prohibited transactions.

No person may offer to enter into, enter into, confirm the execution of, or maintain a position in, any transaction in interstate commerce involving:

(a) Wheat, cotton, rice, corn, oats, barley, rye, flaxseed, grain sorghums, mill feeds, butter, eggs, onions, Solanum tuberosum (Irish potatoes), wool, wool tops, fats and oils (including lard, tallow, cottonseed oil, peanut oil, soybean oil and all other fats and oils), cottonseed meal, cottonseed, peanuts, soybeans, soybean meal, livestock, livestock products and frozen concentrated orange juice, or

(b) Any contract of sale of any commodity for future delivery traded on or subject to the rules of any contract market or involving the prices of such contracts, except under such terms and conditions as the Commission shall prescribe; if the transaction is or is held out to be of the character of, or is commonly known to the trade as, an "option", "privilege", "indemnity", "bid", "offer", "put", "call", "advance guaranty", or "decline guaranty".

17 C.F.R. § 32.4:

Exemptions.

(a) Except for the provisions of §§ 32.2, 32.8 and 32.9, which shall in any event apply to all commodity option transactions, the provisions of this part shall not apply to a commodity option offered by a person which has a reasonable basis to believe that the option is offered to a producer, processor, or commercial user of, or a merchant handling, the commodity which is the subject of the commodity option transaction, or the products or by-products thereof, and that such producer, processor, commercial user or merchant is offered or enters into the commodity option transaction solely for purposes related to its business as such.

(b) The Commission may, by order, upon written request or upon its own motion, exempt any other person, either unconditionally or on a temporary or other conditional basis, from any provisions of this part, other than §§ 32.2, 32.8 and 32.9, if it finds, in its discretion, that it would not be contrary to the public interest to grant such exemption.

WILLIAM J. CAMPBELL, *Senior District Judge*, concurring.

As noted by Judge Cudahy in his opinion, I stated at oral argument that I did not appreciate seeing two federal agencies expend their time and resources fighting a jurisdictional dispute in court. I believe their efforts would be more wisely spent in utilizing their expertise to reach a solution which they would jointly recommend to Congress. Much like cases in which two labor unions fight a jurisdictional dispute, I believe the situation imposed on the Courts by the SEC's headstrong approval of GNMA options trading represents inexcusable intransigence and misguided priorities. (The SEC could at least have waited for the memorandum on jurisdiction due from the CFTC.) Apparently my comments were heeded because subsequently the agencies reached an agreement which will result in the submission of certain proposed legislation to Congress. This course could and should have been pursued at the inception of this controversy and the courts ignored.

However, the agencies initially chose to "dig in" and litigate the issue. They presented this court with a task of statutory interpretation which presents the complexity of the "Gordian Knot" and which, once having been submitted, must be resolved by the court. Not only are we expected to become expert in securities and commodities, master a complex mass of regulatory legislation and historical development, but we must also discern Congressional intent and apply it to a market of financial instruments which did not exist at the time the relevant legislation was enacted. The difficulty of the task would not disturb me if I did not perceive our role in this matter as inappropriate. The proper authority to resolve this matter is, of course, Congress. The fact that Chief Judge Cummings and Judge Cudahy were able to fashion coherent and expert solutions to the problem is not due to the suitability of the task to judicial resolution, but to the individual brilliance and dedication of those men. As is apparent from my vote, I find Chief Judge Cummings' approach more persuasive. Although it is a close and difficult issue, I do not intend by this concurring opinion to qualify in any way my adherence to it. Among other things, I note that Judge Cudahy attaches some weight to "practical considerations" such as the belated compromise of the agencies and the enforcement capabilities of the CFTC. If I were a legislator these considerations might be paramount,

but as a judge faced with an issue of statutory interpretation I am restricted to a more limited ambit of considerations. As noted in footnote 8 of the majority opinion, it is clear that the agencies cannot, through a bilateral agreement, alter the jurisdictional limitations set by Congress. Additionally, the issue of the viability of the CFTC as a regulatory body was never raised in this proceeding, and even if it were, this Court has neither the resources nor the authority to address it.

While the agencies did reach an agreement, that compromise did not eliminate the necessity of this Court resolving the jurisdictional issue. This could have been done by agreeing to stay further action on the GNMA options market until Congress enacted clarifying legislation.

As I have made clear, I believe this dispute should be resolved by Congress and, in the exercise of sound judgment, should never have been brought to this Court. If Congress now chooses to resolve the matter differently it will not necessarily mean that we have erred but that considerations alien to a statutory construction analysis prevailed. However, as the situation stands now, we are relegated the task of unravelling this "Gordian Knot"; Congress can simply cut it.

I have written this concurring opinion not to chastise the parties in this suit, but to highlight an aspect of this case that I believe is important. I would hope that in the future, government agencies would exercise their judgment and discretion to work to resolve their disputes quickly, efficiently, and in the proper forum. Their paramount concern should be the public interest and not their own aggrandizement or the financial interest of private parties.

CUDAHY, *Circuit Judge*, dissenting. I commend Chief Judge Cummings for putting to such exemplary use his abundant resources of scholarship and analysis on behalf of what might be in theory a rational and symmetrical outcome of this jurisdictional muddle. But I regret that his opinion for the majority fails at almost every turn to meet the tests of plain language, congressional intent, historical context and practical result. The opinion throws into disarray the agreement just reached between the CFTC and the SEC which would allow GNMA options trading to go forward forthwith on the CBOE. By reaching the extreme conclusion that the Securities Exchange Commission is without power under its own statutes to regulate options trading in what is incontestably a "security"—GNMA's—, the majority seems to have returned all parties to "square one" in this unseemly regulatory debacle.

I.

In the first place, had Congress wished to confer *exclusive* jurisdiction over options on *actual commodities* (in contrast to options on *futures* contracts) on the CFTC, it could have explicitly incorporated the term "options" at an appropriate place in the exclusive jurisdiction clause (section 2(a)(1) of the CEA, 7 U.S.C. § 2). Congress did just that, for example, in referring expressly to an "option" involving any commodity as one of the species of transactions regulated by section 4c(b) of the CEA (enacted contemporaneously with the exclusive jurisdiction proviso). Instead Congress, in section 2(a)(1) of the Act, used language classically crafted to grant exclusive jurisdiction over the trading of commodity *futures*, including options on such *futures*, to the Commodity *Futures* Trading Commission.

The sharp distinction between Congress' *non-inclusion* of options on GNMA's and other underlying actuals[1] in

[1] The term "actual" refers to the underlying commodity (corn, wheat, silver, pork bellies), security (General Motors stock) or security/commodity (GNMA's) in which futures contracts or option contracts are traded.

the exclusive jurisdiction clause and their *inclusion* in the contemporaneous provisions of section 4c(b) is highlighted in the 1978 Senate Report, which reviewed what Congress had done in 1974:

> As to the newly-regulated commodities, section 201 of the CFTC Act amended section 2(a)(1) of the Act to grant the Commission exclusive jurisdiction over *options involving commodity futures contracts. In addition*, section 402 of the CFTC Act added section 4c(b) of the Act (7 U.S.C. 6c(b). That section permits *options transactions involving the newly-regulated commodities*, subject to Commission rules and regulations . . . .

S. Rep. No. 850, 95th Cong., 2d Sess. 59, *reprinted in* [1978] U.S. Code Cong. & Ad. News 2147 (emphasis added). If, as the majority contends, the phrase "options involving commodity futures contracts" included options on actuals as well as options on futures contracts, then the "[i]n addition" language, with which the second sentence of the quoted paragraph begins, would make no sense.

As the legislative history of the CEA makes clear, Congress enacted the exclusive jurisdiction proviso of § 2(a)(1) so that trading in commodity futures, and related activities with a direct nexus to futures trading, such as discretionary futures accounts, and options on futures contracts, would be subject to regulation by the CFTC only.[2] But the same rationale does not apply to options

[2] *See* S.Rep. No. 850, 95th Cong., 2d Sess. 5-13, *reprinted in* [1978] U.S. Code Cong. & Ad. News 2093-2101 (detailing history of *futures* trading in United States and describing as purpose of the CFTC, the provision of a uniform regulatory structure covering all aspects of *futures trading* in both the regulated and unregulated commodities); S.Rep. No. 1131, 93rd Cong., 2d Sess. 13-17, *reprinted in* [1974] U.S. Code Cong. & Ad. News 5856-60 (describing mechanics of *futures* trading and detailing need for centralized regulatory agency to oversee such trading); Johnson, *The Commodity Futures Trading Commission: Preemption as Public Policy*, 29 Vand. L. Rev. 1, 18 (1976) (clear that 1974 Congress "intended the CFTC to be the sole regulatory authority for the futures industry").

on actuals, which, unlike options on futures, do not have any necessary connection with futures trading. Options on GNMA securities were traded over-the-counter for at least five years prior to the initiation of GNMA futures trading,[3] just as options on stocks have been traded for eight years on the CBOE without the existence of any futures trading in stocks. *See* SEC Record 399-401, 661-68. The existence of such an autonomous GNMA options market both before and after enactment of the 1974 CEA, renders extremely dubious any claim that Congress intended to put such options under the CFTC's exclusive jurisdiction in 1974. This history of over-the-counter trading also casts considerable doubt on the thesis that options on GNMA securities are among the "commodity options" regulated by sections 4c(b) and 4c(c) of the CEA. *See* Part V *infra*.

The current Chairman of the CFTC, in a 1975 article, flatly and succinctly rejected the majority's conclusion that the CFTC has exclusive jurisdiction over options on commodity/securities such as GNMAs.

> The CFTC's exclusive jurisdiction . . . [does] not extend to securities options such as those traded on the Chicago Board Options Exchange, since *such options when exercised, do not result in the delivery of a futures contract.*

Johnson, *The Perimeters of Regulatory Jurisdiction Under the Commodity Futures Trading Commission Act*, 25 Drake L. Rev. 61, 68 (1975) (emphasis supplied).[4] Other

[3] Trading in GNMA futures contracts began in 1975 when the CFTC designated the Chicago Board of Trade as a contract market for GNMA futures. SEC Record 634.

[4] The majority attempts to minimize this explicit conclusion by one of the nation's foremost commodities experts by arguing that Johnson, in his 1975 article, "could cite no authority for this mistaken conclusion." *Ante* at 20 n.18. However, as outside counsel to the Chicago Board of Trade at the time the exclusive jurisdiction clause was enacted, Mr. Johnson was certainly in a favorable position to interpret the scope of the jurisdictional grant for which he and his client were primarily responsible. *See ante* at 19. Moreover, it is, to say the least, inconsistent for the majority to use Johnson's legal analysis to support several aspects of their "involving" theory (*see, e.g., ante* at 17 n.16; 19), yet to dismiss so cavalierly by explicit

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commentators have consistently construed the CFTC's exclusive jurisdiction under section 2(a)(1) to reach options on futures, but not options on the underlying tangibles or intangibles. *See, e.g.*, Bromberg, *Commodities Law and Securities Law—Overlaps and Preemptions*, 1 J. Corp. L. 217, 313 (1976); Long, *Commodity Options—Revisited*, 25 Drake L. Rev. 75, 132 (1975); Guttman, *The Futures Trading Act of 1978: The Reaffirmation of CFTC—SEC Coordinated Jurisdiction over Securities/Commodities*, 28 Am. U. L. Rev. 1, 30 (1978).

The majority's almost total reliance on the word "involving" in the exclusive jurisdiction clause to bear the crushing burden of options on actuals is to rest the Rock of Gibraltar on a toothpick. The phrase "transactions involving contracts of sale of a commodity for future delivery" is of ancient origin and established meaning. In the Grain Futures Act of 1922 the phrase "[t]ransactions in grain involving the sale thereof for future delivery as commonly conducted on boards of trade" was used to distinguish futures transactions from certain other grain transactions.[5] This section of the Grain Futures Act of 1922 (derived from the Futures Trading Act of 1921) applied only to *futures* contracts and options on *futures*. *See Trusler v. Crooks*, 269 U.S. 475, 481-82 (1926). Moreover, the policy declaration currently found in § 5 of the CEA, which has survived *intact*[6] since the Grain Futures Act of 1922, contains the precise "involving" construction found in the CFTC's exclusive jurisdiction clause.[7] Certainly, it is reasonable to assume

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[4] *continued*
conclusion regarding the limited scope of the CFTC's exclusive jurisdiction.

[5] *See* Act of Sept. 21, 1922, ch. 369, § 3, 42 Stat. 999.

[6] Except for the substitution of "commodity" for "grain" in 1936. *See* Act of June 15, 1936, ch. 545, § 2, 49 Stat. 1491.

[7] 7 U.S.C. § 5 (1980) provides in pertinent part:

> Transactions in commodity *involving the sale thereof for future delivery* as commonly conducted on boards of trade and *known as "futures"* are affected with a national public interest;

(emphasis supplied).

that by using an existing phraseology, derived from old statutes of clear meaning, Congress in 1974 intended to encompass only the type of options transactions which had previously been regulated under the CEA and predecessor statutes.[8]

An additional reason for Congress to use the term "involving" (rather than the preposition "in") in the exclusive jurisdiction clause is that such a construction was necessary to comport with the clause's earlier reference to "accounts" and "agreements." As the current Chairman of the CFTC has explained, the Senate Agriculture and Forestry Committee in 1974 modified the proposed exclusive jurisdiction clause to apply to "accounts" and "agreements" as well as transactions in futures contracts. "This important change extended the Act to the activities surrounding trading, such as the regulation of so-called 'discretionary accounts' or 'discretionary agreements' common in futures trading, which had sometimes been treated as 'securities' in the courts." Johnson, *The Commodity Futures Trading Commission Act: Preemption as Public Policy*, 29 Vand. L. Rev. 1, 14 (1976).[9] The Senate language prevailed in the Conference Committee. With the addition of "accounts" and "agreements," it was necessary, to achieve any semblance of precision, to

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[8] It may well be true, as both the majority and the CBOT have argued, that much of the divergence between securities options trading and futures trading "has been fortuitous." *Ante* at 6 n.2. Given this divergence, however, it is the job of Congress, not this court, to reunite the two markets if it so desires. Surely, not even the majority would suggest that the corporate stock options currently being traded on the CBOE have been brought within the CFTC's exclusive jurisdiction as a result of the trading in stock index futures recently inaugurated on the Kansas City Board of Trade. *See* note 11 *infra*.

[9] This desire to extend the CFTC's exclusive jurisdiction to collateral activities surrounding futures trading also explains the "relating to" language proposed by the House Committee on Agriculture. *See* Johnson, 29 Vand. L. Rev. at 10-11; Majority Opinion at 19-20.

employ the term "involving," rather than the preposition "in," and there is no suggestion in the legislative history that this choice of preposition somehow acted to extend the CFTC's exclusive jurisdiction to options on actuals in contrast to options on futures contracts. In fact, by specifying that the term "agreement" in § 2(a)(1) includes an "option," Congress indicated that the complementary phrase "transactions involving contracts of sale . . . for future delivery" did not. Any other reading would render Congress' express reference to "option" wholly redundant and would thus violate the fundamental maxim of statutory construction that "a Legislature is presumed to have used no superfluous words." *Platt v. Union Pacific R. R. Co.*, 99 U.S. 48, 58 (1878).

A more fundamental problem with relying on the term "involving" to drag in options on the actual underlying commodity/security is that such a construction proves far, far too much. If, as the majority contends, trading in commodity options necessarily "involves" commodity futures, then all security options could become subject to the CFTC's *exclusive jurisdiction* as soon as anyone commenced futures trading in the underlying financial instrument. This is not merely a parade of horribles argument since at least one commodities exchange has applied for permission to trade futures in American Telephone and Telegraph Company bonds. 46 Fed. Reg. 30,844 (1981).[10] The Chicago Board of Trade itself has applied for designation as a contract

[10] Unlike the majority, *ante* at 28 & n.26, I do not purport to characterize American Telephone and Telegraph bonds as either "legitimate" or "illegitimate" commodities, whatever those terms may denote. Rather, I regard the potential for futures trading in AT&T bonds as demonstrating the fundamental flaw in the majority's analysis. Under the clear definitional provisions of the CEA, AT&T bonds will become "commodities" within the meaning of the Act as soon as futures trading on them has been authorized. And, according to the majority's "involving" theory, once AT&T bonds have become "commodities" *all options trading* on the underlying financial instrument will be subject to the CFTC's *exclusive jurisdiction*, a result which I do not believe Congress could possibly have intended.

market to trade averages of groups of corporate stocks. 46 Fed. Reg. 7042 (1981).[11]

The majority, of course, recognizes some of the pitfalls into which its "involving" argument must lead. It responds with tortured and unsupportable distinctions between exempt and nonexempt securities and traditional and nontraditional commodities. *See ante* at 27-33. These distinctions are not to be found in the CEA, and they simply do not withstand serious analysis. Moreover, the very need to manufacture such "limits" demonstrates the implausibility of the majority's reliance on the term "involving" to revolutionize (and unfortunately, to disrupt) the jurisdictional relationships among federal security and commodity regulatory agencies.

As a practical matter, the view of the majority that trading in GNMA options necessarily "involves" GNMA futures is purely speculative (no pun intended) and finds no support in the record. The SEC in this administrative proceeding found as a fact that options and futures were separate and distinct instruments and that GNMA options could be regulated separately from GNMA futures.[12] We must accept these findings unless they are unsupported by substantial evidence. *See* 15 U.S.C. § 78 (y)(a).[13] In any event, even the majority admits that

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[11] Indeed, trading in such stock-index futures has already begun on the Kansas City Board of Trade. Wall St. J., Feb. 25, 1982, at 30.

[12] *See, e.g.*, SEC Record 2-4 (distinguishing between GNMA futures and GNMA options trading and rejecting CBOT contention that proposed GNMA options are within the jurisdiction of the CFTC). *See also* Comment Letters reprinted at *Id.* 365-66 (futures "are not a consistently useful vehicle for hedging the risk present in the conventional loan origination market"), and *Id.* 466 (GNMA futures market is a *mandatory* delivery market and, as such does not serve the same economic function as an options market).

[13] The administrative history of the challenged SEC order demonstrates that the SEC carefully considered all aspects and implications of GNMA options trading before approving CBOE's requested rules change. On May 12, 1980, the SEC

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[18] *continued*
published notice of CBOE's proposed rules change and invited public comments to be filed by July 15, 1980. It also wrote to a number of Government agencies, including the CFTC, to inform them officially of CBOE's proposal and to furnish them with a copy of CBOE's proposed rules for trading GNMA options. The SEC again wrote to the same Government agencies on July 11, 1980, specifically to request comments on CBOE's proposal. On July 24, 1980, the SEC issued a news release extending the public comment period to September 1, 1980, and soliciting additional comments concerning particular features of CBOE's proposed options contract, including an evaluation of the market and regulatory environments within which these instruments would be traded. *See* SEC Record 116-27.

The SEC received 85 comment letters concerning the CBOE proposal, all but one of which—the submission of the CBOT—were essentially supportive. SEC Record 4. These included comments from interested Government agencies—the Government National Mortgage Association, the Department of Housing and Urban Development, the Department of the Treasury, the Federal Reserve Bank of New York, the Board of Governors of the Federal Reserve System and the CFTC—as well as from a large number of mortgage bankers, the Mortgage Bankers Association of America, a number of investment bankers and securities dealers, and the Securities Industry Association. In general, these comments emphasized (1) that options on GNMA securities had been a traditional financing vehicle in the mortgage banking industry and were essential to sound construction financing; (2) that for a variety of economic reasons GNMA options had generally become unavailable in the dealer (over-the-counter) markets; (3) that GNMA options serve needs that are not filled by the availability of futures contracts; and (4) that there was an urgent public need for the prompt approval and implementation of the type of GNMA option market proposed by CBOE. The comment letters also noted that the proposed CBOE market would greatly enhance the regulatory environment for the trading of GNMA options and would be likely to cure the abuses that had been occurring in the over-the-counter GNMA options market. *See* SEC Record 471, 519, 522-27, 534-37, 635.

On February 26, 1981, the SEC entered its order approving CBOE's proposed rules change. The SEC expressly found that "it is appropriate for the CBOE to amend its rules to provide

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futures contracts and options are legally and historically distinct instruments. *Ante* at 3-4, 29. An option on a GNMA security imposes a duty to perform on only one party, the writer of the option. The holder of the option, by contrast, is under no obligation to exercise the option or enter into any later transaction, having acquired this right through payment of a premium. The unique feature of an options contract is the ability of its holder to limit any potential for loss to the amount of the premium paid for the option. *See generally*, Moriarty, Phillips & Tossini, *A Comparison of Options and Futures in the Management of Portfolio Risk*, Financial Analysts Journal 61, 62 (Jan./Feb. 1981). In direct contrast to this feature, each party to a futures contract assumes an unconditional obligation to perform.[14] To be

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[13] *continued*
for trading of options on GNMA securities" and that "the proposed rule change is consistent with the requirements of the [Securities Exchange] Act and the rules and regulations thereunder and, in particular, the requirements of Section 6." SEC Record 13. The SEC considered the arguments raised by the CBOT that GNMA options were within the CFTC's jurisdiction and subject to the ban on commodity options provided in the CEA, but rejected these arguments on the ground that "the CEA is not applicable to the trading of options on GNMA securities, particularly where the trading is on a national securities exchange." SEC Record 4 n.13.

[14] Congress, in both 1974 and 1978, was well aware of the difference between options and futures. The 1978 Senate Report defines "Futures Contract" as "A *firm commitment* to deliver or receive a specified quantity and grade of a commodity during a designated month with price being determined by public auction among exchange members." S. Rep. No. 850, 95th Cong., 1st Sess. 128 (1978), *reprinted in* [1978] U.S. Code Cong. & Ad. News 2165 (emphasis added). The same Senate Report defines an "Option" as

> (1) A term sometimes *erroneously applied to a futures contract* . . .
>
> (2) The right, acquired for a price, to buy and sell a commodity at an agreed upon price within a specified time.

Id. at 132, *reprinted in* [1978] U.S. Code Cong. & Ad. News 2139 (emphasis supplied). *See also* 1974 House Report at 130

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sure, parties trading either options or futures in organized markets will, in practice, generally enter into off-setting transactions to liquidate their positions prior to the expiration of the option or futures contract. The availability of an off-set market, however, cannot duplicate the unique function performed by the option in limiting the extent of the holder's possible loss. *See, e.g.*, SEC Record 350, 438, 466. Anyone who has sold futures in a market which subsequently rises inexorably has no difficulty distinguishing a futures contract from an option. Moreover, both the courts and the CFTC have recognized that commodity options are not the same thing as commodity futures. *See Precious Metals Associates, Inc. v. CFTC*, 620 F.2d 900, 905 (1st Cir. 1980) (distinguishing between commodity options and commodity futures contracts); *CFTC v. U.S. Metals Depository Co.*, 468 F. Supp. 1149, 1155 (S.D.N.Y. 1977) (same); *CFTC v. Crown Colony Commodity Options, Ltd.*, 434 F. Supp. 911, 913-14 (S.D.N.Y. 1977) (same); *Reauthorization of the Commodity Futures Trading Commission, Hearings Before the Senate Subcomm. on Agricultural Research and General Legislation of the Comm. on Agriculture, Nutrition and Forestry*, 95th Cong., 2d Sess. 361-62 (1978) (same distinction made by the then Chairman of the CFTC).

I am willing to presume that there is some economic linkage between GNMA options and GNMA futures. The price of both is presumably linked to the inflation rate, the size of the federal deficit, the Federal Reserve Board's growth target for the money supply, prospects for growth or decline in the economy, etc. I am also willing to concede that both options and futures may be used to "shift risks"—to permit those who hold GNMA's in inventory to shift the risk of price decline. But none of this tells me that options and futures must therefore be traded under the roof of the same exchanges or that such trading must necessarily be regulated by the same

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[14] *continued*

(defining futures contract as a "legally binding commitment to deliver or take delivery of a given quantity and quality of a commodity at a price agreed upon when the contract is made. . . .").

government agency. It is not for us to torture the plain language of statutes or ignore traditional regulatory arrangements merely because we perceive economic linkages or similarities in economic function among various financial instruments.[15] Presumably Congress has the benefit of these economic insights and may dispose as it sees fit. But certainly there is nothing in the record or elsewhere requiring the conclusion that GNMA options inextricably "involve" GNMA futures and that the regulatory scheme must be recast to reflect such an "involvement."[16]

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[15] Moreover, as both Congress and the CFTC have recognized, there is also a strong economic linkage between futures trading and trading in the underlying actual commodities. *See, e.g.*, 7 U.S.C. § 4a(g)(2) (1980). Indeed, one basic justification for a futures market is that futures trading in a central location performs a "price discovery" function for the underlying commodity, thereby furnishing producers and users a reference point for their pricing on the cash market. *See* 1974 Senate Report at 12; Majority Opinion at 28-29. Congress has, in fact, required the CFTC, in determining whether to approve a proposed futures contract, to assess whether the contract will fulfill such a "price discovery" function for the interdependent cash market. *See* 1974 House Report at 12; 1974 Conference Report (H.R. Rep. No. 1383, 93d Cong., 2d Sess.) at 36. The logical import of the majority's "involving" theory would thus appear to extend the CFTC's exclusive jurisdiction to transactions in the cash commodities themselves, notwithstanding Congress' clear intent to the contrary. trary.

[16] Indeed it seems naive to argue, as the majority appears to, *ante* at 30-32, that giving exclusive jurisdiction over the trading of GNMA options to an agency already experiencing severe difficulties combating manipulation and deceptive trading practices in the commodities industry, *see* note 44 *infra*, rather than to an agency that has consistently demonstrated its ability to effectively regulate securities trading, will *minimize* the potential for manipulation and abuse. Nor do the portions of the SEC record cited by the majority support its anti-manipulation argument, since the opportunities for intra-market manipulation discussed in those comment letters (written in response to specific SEC inquiries) will exist regardless whether trading in GNMA op-

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The majority's reliance on the statement of the 1974 Senate Committee that "the [CFTC's] jurisdiction over futures contracts markets or other exchanges is exclusive and includes the regulation of commodity accounts, commodity agreements and *commodity options*," *ante* at 20, is similarly misplaced. This statement expressly limits the CFTC's exclusive jurisdiction to options and trading agreements on commodity *futures* contracts, since those are the only types of collateral transactions which take place on a *futures* contract market or other exchange subject to the CFTC's regulatory jurisdiction.[17] Any other reading of the statement would produce unintended and extreme results, since it would give the CFTC *exclusive jurisdiction* over *any* commodity/security transaction taking place on *any* security exchange, a construction which would presumably include accounts and agreements relating to the trading of actual GNMA certificates as well as GNMA options.

Nor does the fact, that Congress, in 1975 and 1978, rejected the SEC's attempts to abolish CFTC jurisdiction over *all* transactions in GNMA's (and other security/commodities) support the majority's broad "involving" theory. The SEC proposals rejected by Congress in 1975 and 1978 would have prohibited the CFTC from exercising jurisdiction over any transaction, *including a futures contract*, involving any security.[18] *See, e.g., Hearings on H.R. 10285 Before the Subcommittee on Conservation and Credit of the House Committee on*

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[16] *continued*
tions and GNMA futures is regulated by the same or different agencies. Finally, the 1978 testimony of then SEC Chairman Williams, quoted in footnote 27 of the majority opinion, runs directly counter to the majority's policy argument, since Williams, at the time, was advocating that jurisdiction over *all* forms of security trading—including futures trading—be vested in the SEC.

[17] *See Securities and Exchange Comm. v. Weeks Securities, Inc.*, 483 F. Supp. 1239, 1245 (W.D. Tenn. 1980).

[18] Thus, in 1978, the proposed SEC amendment would have rendered illegal the extensive trading in GNMA futures then taking place on the CBOT.

Agriculture, 95th Cong., 2d Sess. Ser. No. 95-QQ187-88, 209 (1978) (statement of SEC Chairman Harold Williams); *Hearings Before the Senate Subcommittee on Banking, Housing and Urban Affairs on § 249*, 94th Cong., 1st Sess. 244 (1975). It was this withdrawal of CFTC jurisdiction over *futures trading*, including options on such futures contracts, that Congress was unwilling to countenance.[19] The majority's attempt to use this Congressional decision to support its thesis that Congress intended to vest the CFTC with exclusive jurisdiction over options on the underlying securities themselves finds no support in the statute or its legislative history.[20] The majority's citation of *Inter-*

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[19] S.Rep. No. 850, 95th Cong., 2d Sess. 22-23, *reprinted in* [1978] U.S. Code Cong. & Ad. News 2110-11:

> The changing nature of futures markets has stimulated the proposals of the SEC and the Department of the Treasury for increased jurisdiction by them *in specific areas of futures trading*. In each case, their proposals stem from their interest in certain underlying "commodities" . . .
>
> The committee understands the basis of the Securities and Exchange Commission proposal and appreciates the interest of the Department of the Treasury in examining the integrity of markets for Government securities. However, the basic conclusion reached in 1974 that there should be a *single regulatory agency responsible for futures trading* is as valid now as it was then.

(emphasis added). *See also* Johnson, *The Commodities Futures Trading Commission Reauthorization Process: A View From the Trenches*, 1979 Det. Col. L. Rev. 1, 3-4, 13-14 (SEC proposal "urged that all forms of trading in securities—futures, options and ordinary sales— should be 'vertically integrated' in one agency: the SEC. . . . The SEC's proposal was to redefine the term 'commodity' so that the CFTC would lose jurisdiction entirely and the SEC (and Treasury) would replace it.")

[20] The majority relies on a 1975 letter written by then SEC chairman Ray Garrett, Jr. stating that, without the SEC's proposed amendment, § 2(a)(1) of the CEA "may well call into question the continuing jurisdiction of the SEC over options trading, including that on the CBOE and the American Stock Exchange, Inc.," *ante* at 25. Congress quite reasonably con-

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national Trading, LTD. v. Bell, 556 S.W.2d 420, 425-26 is similarly inapposite since the court, in that case, was concerned solely with the CFTC's jurisdiction over options on commodity futures contracts.[21]

Equally damaging to the majority's interpretation of the subsequent legislative history of the CEA is the fact that at the same time Congress rejected the SEC's attempts to remove CFTC jurisdiction over futures trading in the newly developing security/commodities, it adopted amendments to the CEA specifically directing the CFTC to "maintain communications" with the SEC regarding the potentially overlapping jurisdiction of those two agencies. 7 U.S.C.A. § 41(a)(g)(2) (1980). If, as the majority contends, the CFTC possessed exclusive jurisdiction over the trading of security options as well as security futures, there would seem to be little purpose in requiring the two agencies to confer and cooperate on jurisdictional matters. Indeed, the 1978 House Conference Report, explaining the import of this amendment, noted that it "requires the [CFTC] to maintain communication with the Department of the Treasury, the Board of Governors of the Federal Reserve System, *and the SEC* [in order] . . . to consider the relationship between the volume and nature of investment and trading in futures, *compared to* securities and financial instruments within their jurisdiction." H. Conf. Rep. 1628, 95th Cong., 2d Sess 17 (1978), *reprinted in* [1978] U.S. Code Cong. & Ad. News 2178 (emphasis added). Such a choice of wording clearly reflects Congress' con-

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[20] *continued*
cluded that these fears were unwarranted, since both the language and the legislative history of § 2(a)(1) preserved SEC jurisdiction over options trading in securities. *See, e.g.*, 1974 Senate Report at 26, *reprinted in*, [1974] U.S. Code Cong. & Ad. News 5866; 120 Cong. Rec. 34, 736-37 (1974) (remarks of Representative Poage).

[21] *See* 556 S.W.2d at 422 (defining relevant commodity option as "a contract right . . . to buy from or sell to the option seller, the *underlying commodity futures contract* at a fixed price . . . at any time during the life of the option.") (emphasis added).

tinuing awareness that only investment and trading in *financial futures* falls within the exclusive jurisdiction of the CFTC. At the very least, this statutory directive evinces Congress' strong desire that the SEC and the CFTC consult and cooperate for the purpose of devising an acceptable sharing of jurisdiction over instruments in which both agencies possess an interest. It is precisely this statutorily mandated process of cooperation and consultation that the majority opinion now seeks to dismantle.

II.

The legislative history of both the 1974 and the 1978 amendments to the CEA indicates that the SEC "Savings Clause" was designed to preserve SEC jurisdiction over *all* security options, including options on GNMAs. Perhaps the clearest indication of this Congressional intent is found in the Senate Report accompanying the 1974 Amendments:

> The committee intends that options not be traded except on organized exchanges and in conformity with the rules and regulations of the Commission. However, the Commission *would not have the authority to regulate trading in puts and calls for securities. Where traded on exchanges, these puts and calls are regulated by the Securities and Exchange Commission.* Where traded among banks, they are regulated by the bank regulatory agencies.

1974 Senate Report at 26, *reprinted in* [1974] U.S. Code Cong. & Ad. News 5866 (emphasis supplied).[22]

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[22] Examination of this statement in its entirety renders untenable the majority's suggestion that the Senate Committee's reference to "securities" in this passage covers only "traditional, corporate stocks" and does not include "non-traditional [financial] instruments" such as GNMAs. *Ante* at 22-23 & n.22. Under 12 U.S.C.A. § 24 (1980 Supp.) nationally chartered banks are generally prohibited from owning or dealing in corporate stocks and bonds. Most state banks are subject to similar restrictions. *See, e.g.*, Ill. Rev. Stat. ch. 17,

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Other portions of the 1974 Senate Report confirm Congress' clear desire to exempt from the CFTC's exclusive jurisdiction *all* trading in securities and security options *not* conducted on a commodity futures exchange. Thus, in its "Section-By-Section Analysis" of the 1974 Amendments, the Senate Report states:

> Section [2(a)(1)] . . . enlarges the definition of "commodity" . . . and provides for the *exclusive jurisdiction of the Commission over all futures transactions which are executed on domestic boards of trade.* The Commission will have *exclusive jurisdiction over options trading in commodities (but not in securities).*

1974 Senate Report at 31, *reprinted in* [1974] U.S. Code Cong. & Ad. News 5870 (emphasis added).[23] Similarly, the 1974 Conference Report explains:

> Under the exclusive grant of jurisdiction to the [CFTC], the authority in the Commodity Exchange Act . . . would preempt the field *insofar as futures regulation is concerned.*

S. Rep. No. 1194, 93d Cong., 2d Sess. 35 (1974) (emphasis added).[24]

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[23] *continued*
§§ 3130, 3131 (1981); IND. CODE § 28-1-11-4 (1976); 26 WIS. STAT. ANN. § 219.01 (1957 & 1981 Supp.). *Cf.* CAL. FIN. CODE § 1364 (1968 & 1981 Supp.) (allowing state banks to invest up to 10% of their savings deposits in debt instruments of U.S. corporations meeting strict financial requirements). Since the final sentence of the Senate Report explicitly refers to "puts and calls for securities" that are traded among banks, the phrase must necessarily include options on non-corporate financial instruments such as GNMAs.

[23] *See also* 1974 Senate Report at 23, *reprinted in* [1974] U.S. Code Cong. & Ad. News 5863:

> While the Committee did wish the jurisdiction of the Commodity Futures Trading Commission to be *exclusive with regard to the trading of the futures on organized contract markets*, it did not wish to infringe on the jurisdiction of the Securities and Exchange Commission
> . . . .

[24] The suggestion of the majority, *ante* at 24, that preserving SEC jurisdiction over the trading of security options on a

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Notwithstanding this careful limitation of the CFTC's exclusive jurisdiction, and Congress' repeated assertions that section 2(a)(1) of the CEA was not intended to usurp the SEC's jurisdiction over securities and security options, several legislators remained concerned about possible unintended effects on SEC jurisdiction. In a final effort to allay this concern, both House Committee Chairman Poage and Senate Committee Chairman Talmadge made the following clarifying statement immediately prior to the vote on the 1974 CEA Amendments:

> I understand that there is some concern that, in effectuating the intent to fill regulatory gaps, the conference substitute appears to have an unintended impact on the jurisdiction of the Securities and Exchange Commission.
>
> This misconception apparently has arisen because of certain provisions in [Section 2(a)(1)] . . ., in particular, the revised definition of commodities, the limited grant of exclusive jurisdiction to the Commodity Futures Trading Commission, and the reference to trading in futures contracts and options, not only on designated contract markets, but also on "any other board of trade, exchange or market."
>
> I wish to emphasize that the words "any other board of trade, exchange or market" were included *only for the purpose of giving the Commodity Futures Trading Commission jurisdiction over futures contracts purchased and sold in the United States and executed on a foreign board of trade, exchange or market. This grant of exclusive jurisdiction is not*

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[24] *continued*

national security exchange might somehow allow the CBOE to "trade wheat options or onion futures" is ridiculous since—unlike GNMAs—neither wheat nor onions can possibly be characterized as a security. The majority's further contention that "the dissent thus reads the legislative history inconsistently with the clear words of the statute" is similarly flawed, since the purportedly broad statutory reach to which the majority refers depends *entirely* on its strained construction of the term "involving."

to be construed as preempting the jurisdiction of the Securities and Exchange Commission over securities, including stock options, traded on any national securities exchange or any other U.S. securities market.

With respect to the definition of commodities, it was intended to apply to a broader class of goods, articles, rights and interests than previously were subject to the Commodity Exchange Act. *It was not intended, however, to apply to trading in interests and rights traditionally known as securities, including, for example, stocks, corporate bonds, warrants, and debentures; nor was it intended to apply to trading in options to purchase any of the foregoing.*

120 Cong. Rec. 34,736-37, 34,997 (1974) (emphasis added).

The majority quotes only the final paragraph of this statement and seeks to interpret Chairman Poage's reference to "interests and rights traditionally known as securities" as being limited to "corporate stocks and the like." *Ante* at 22-23 n.22. Such an interpretation is resoundingly wrong. The corporate securities specifically enumerated by Chairman Poage were meant only as illustrative examples of the SEC's traditional jurisdiction and were not in any way intended as limitations.[23] Indeed, the current Chairman of the CFTC (then outside counsel to the CBOT) has himself described GNMA certificates as "traditional securities." Johnson, *The Commodity Futures Trading Commission Reauthorization Process: A View from the Trenches*, 1974 Det. C.L. Rev. 1, 12. Even the majority does not argue that GNMAs are not "securities," and it seems clear that as a species of mortgage, they are unarguably "traditional." Moreover, the three paragraphs that precede Chairman Poage's

[23] *See P.C. Pfeiffer Co. v. Ford*, 444 U.S. 69, 77-78 n.7 (1979) ("including" indicates that subsequent terms "comprise a part of the larger group"); *Federal Lark Bank v. Bismark Lumber Co.*, 314 U.S. 95, 100 (1941) ("the term 'including' is not one of all-embracing definition, but connotes simply an illustrative application of the general principle").

reference to trading in traditional security interests underscore the carefully circumscribed boundaries of the CFTC's exclusive jurisdiction.

Finally, the CFTC's previous statements of position indicate that it has traditionally viewed the SEC "Savings Clause" as restricting to direct regulation of the futures market its own jurisdiction over security/commodities such as GNMAs. In 1975, in response to an SEC challenge, the CFTC vigorously defended its exclusive authority to approve the trading of GNMA *futures* on the CBOT. At the same time, however, the CFTC was careful to note that it possessed jurisdiction over government backed security/commodities such as GNMAs "*solely with respect to futures trading* in those instruments."[26] Indeed, until it prepared its *amicus* brief in the instant proceeding, the CFTC clearly believed that trading in GNMA options was excluded from the coverage of the CEA. Thus, although GNMA "standby" options[27] have long existed in the over-the-counter markets, the CFTC has never regarded them as being subject to the prohibitions of CEA sections 4c(b) or 4c(c).[28] In its comments to the SEC regarding the CBOE

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[26] Memorandum of the Office of the General Counsel of the CFTC Concerning the Exclusive Jurisdiction of the Commission over Futures Transactions, [1975-1977 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,177, at 20,834 (Dec. 8, 1975) (emphasis added). *See id.* at 20,835 (CEA grants CFTC exclusive jurisdiction "over *futures transactions* executed on any organized board of exchange or trade;" SEC jurisdiction "limited to activities not meeting the foregoing description.").

[27] A "standby" option is a forward contract giving one party to the contract the option to make delivery of specified GNMA securities at or before a specified date. This arrangement is also denominated a "put" option. *See* SEC Record 376, 397, 435; Majority Opinion at 43.

[28] For example, in November, 1976, the CFTC adopted comprehensive commodity option regulations, 17 C.F.R. § 32.1 *et seq.*, 41 Fed. Reg. 51808, *et seq.* (Nov. 24, 1976), to govern options transactions in the newly regulated commodities. Part 32.2 of these regulations *absolutely prohibited* all options

(Footnote continued on following page)

options proposal, the CFTC expressly recognized the existence of the over-the-counter GNMA options market and stated that the proposed CBOE options market would be likely to result in more efficient pricing, greater liquidity, more streamlined clearing and delivery procedures, improved regulation and greater financial integrity than the existing GNMA standby options market.[29] Proposed CFTC Regulation 34.1, which would exempt from the "options ban" in CEA section 4c(c) and from Parts 32 and 33 of the CFTC Regulations "*any transaction in an option on exempted securities . . .* if conducted on a national securities exchange registered with and regulated by the SEC"[30] merely confirms the CFTC's longstanding recognition of this jurisdictional limitation.

III.

Even if it were not clear from the language of section 2(a)(1) and from the SEC "Savings Clause" that the CFTC's exclusive jurisdiction does not extend to the trading of security options on a national security exchange, a closely related provision of section 2(a)(1)

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[28] *continued*

transactions "*involving* . . . any contract of sale of any commodity for future delivery traded on or subject to the rules of any contract market" (emphasis supplied). Although Part 32.4 of these regulations exempted so-called "dealer options" from some CFTC restrictions, this exemption *did not apply* to the absolute prohibition found in Part 32.2. Thus, if the majority's interpretation of the phrase "transactions involving contracts of sale of a commodity for future delivery. . ." were correct, these 1976 regulations would have completely shut down the then existing GNMA standby market.

[29] *See* SEC Record 631-35.

[30] 47 Fed. Reg. 7677, 7678 (Feb. 22, 1982) (footnote omitted) (emphasis supplied). Pursuant to section 4c(c) of the CEA, the CFTC transmitted this proposed rule to the House and Senate Agriculture Committees on February 19, 1982. *See also* note 43 *infra*.

demonstrates that the CEA cannot be read to prohibit the CBOE's proposed options program:

> Nothing in this Act shall be deemed to govern or in any way be applicable to transactions in . . . security warrants, security rights, . . . government securities, or mortgages and mortgage purchase commitments, unless such transactions involve the sale thereof for future delivery conducted on a board of trade.

This exclusionary sentence—the so-called Treasury Amendment—was added to the CEA in 1974 at the request of the Department of the Treasury, which feared that absent such a clarifying amendment, the new provisions of the CEA might be construed to apply to forward trading and other kinds of transactions in government-backed financial instruments. *See* 1974 Senate Report at 51, *reprinted in* [1974] U.S. Code Cong. & Ad. News 5889. As the 1974 Senate Report makes clear, the Treasury Amendment was designed to establish beyond dispute that trading in the enumerated financial instruments would not be subject to CFTC jurisdiction "unless such trading is conducted on a formally organized futures exchange." 1974 Senate Report at 23, *reprinted in* [1974] U.S. Code Cong. & Ad. News 5863. The 1978 Senate Report re-emphasized this point:

> When the 1974 amendment was being considered by Congress, the Treasury recommended that the *role of the CFTC with respect to Government securities be limited to futures contracts sold on organized exchanges. Congress adopted this recommendation.*

1978 Senate Report at 47, *reprinted in* [1978] U.S. Code Cong. & Ad. News 2135 (emphasis added).

The CBOE's proposed GNMA options fall within the plain language of the Treasury Amendment. First, an option is a right to purchase or sell the underlying security; it is, in short, a "security right[]."[21] Second,

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[21] The majority's rejection of this argument on the grounds that while a call option may be characterized as a security

(Footnote continued on following page)

every GNMA option represents a "mortgage purchase commitment"—that is, a commitment by the writer of the option to purchase (in the case of a put) or to sell (in the case of a call) the pools of mortgages represented by the underlying GNMA. Finally, GNMA securities are unquestionably "government securities." Thus, transactions in GNMA options are "transactions in . . . government securities" under the Treasury Amendment. The majority's suggestion that "transactions in . . . government securities" covers only transactions in which the underlying securities change hands is flatly contradicted by the structure of this passage. The Treasury Amendment provides that the CEA shall not apply "to transactions in . . . government securities, . . . *unless such transactions involve the sale thereof for future delivery conducted on a board of trade.*" (emphasis supplied). If, as the majority contends, "transactions in . . . government securities" referred only to the purchase and sale of the underlying financial instruments, then the clause "unless such transactions involve the sale thereof for future delivery . . ." would be both superfluous and contradictory. As the majority opinion itself makes clear, the GNMA futures market, like the GNMA options market, "may exist without any transactions in the commodity itself." *Ante* at 36. *See id.* at 3-4.

The majority also seeks to avoid the plain language of the Treasury Amendment by arguing that the Amendment was adopted by Congress "only to prevent dual regulation by the CFTC and bank regulatory agencies of the banks and other sophisticated institutions that

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[81] *continued*

right, a put option cannot, would lead to the absurd result that the CFTC would have jurisdiction over one-half of the CBOE's proposed options market (the put options), but not the other. Moreover, courts and commentators have routinely held that both put and call options constitute "security rights." *See, e.g., Mansbach v. Prescott Ball & Turben*, 598 F.2d 1017, 1026 n.40 (6th Cir. 1979); *Securities & Exchange Comm. v. American Commodity Exchange, Inc.*, 546 F.2d 1361, 1366-67 (10th Cir. 1976); *Securities & Exchange Comm. v. G. Weeks Securities, Inc.*, 483 F. Supp. 1239, 1242-44 (W.D. Tenn. 1980); I L. Loss, Securities Regulation 469 (2d ed. 1961).

ordinarily trade in the enumerated financial instruments." *Ante* at 36. While it is true that the Treasury Department advised Congress that trading in the enumerated instruments "generally" took place between banks and other sophisticated institutions,[32] the plain language of the amendment is not qualified in any respect to limit its application to transactions among institutional participants. Where, as here, the language of a statute is unambiguous, we should not hesitate to give the words employed by Congress "their ordinary and common meaning," *Perrin v. United States*, 444 U.S. 37, 42 (1979), at least absent "rare and exceptional circumstances." *Rubin v. United States*, 449 U.S. 424, 430 (1981). In the instant case, neither the language of the CEA nor its legislative history supports the engrafting of a "sophisticated institution" limitation onto the Treasury Amendment.[33]

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[32] *See* Letter from Donald L. E. Ritger, Acting General Counsel, Department of the Treasury to Hon. Herman E. Talmadge, Chairman, Senate Comm. on Agriculture and Forestry, July 30, 1974, *reprinted in* 1974 Senate Report at 49-51.

[33] Indeed the legislative history strongly indicates that no such limitation was intended. *See* 1974 Senate Report at 31, *reprinted in* [1974] U.S. Code Cong. & Ad. News 5870 ("However, transactions in foreign currency, security warrants and rights . . . government securities or . . . mortgage commitments would not be subject to the act unless they involve the sale thereof for future delivery conducted on a Board of Trade"); 1978 Senate Report at 47, *reprinted in* [1978] U.S. Code Cong. & Ad. News 2135 (role of CFTC with respect to Government securities "limited to futures contracts sold on organized exchanges").

The majority's suggestion, *ante* at 37 n.34, that the plain language of the Treasury Amendment is supported by "only the text of a letter to the Senate Committee from the Treasury Secretary" is thus incorrect, and is further refuted by the very portion of the 1974 Senate Report quoted by the majority. As that portion of the 1974 Senate Report explains:

> [R]egulation by the [CFTC] of transactions in the specific financial instruments . . ., which *generally* are between

(Footnote continued on following page)

IV.

In Part III of its opinion the majority reaches the startling conclusion that the SEC is without jurisdiction—under its own statutes—to regulate options trading in GNMA securities, a contention which, if true, would render the first two sections of the opinion entirely gratuitous. In the first place, this contention should not even be considered on this appeal, since it was not presented in the administrative proceedings before the SEC. Section 78y(c)(1) of the Securities and Exchange Act of 1934 (SEA), 15 U.S.C.A. § 78y(c)(1) (1980 Supp.), explicitly provides:

> No objection to an order or rule of the Commission, for which review is sought under this section, may be considered by the court unless it was urged before the Commission or there was reasonable grounds for failure to do so.

Although the CBOT, both on its own and through its attorneys, submitted extensive comments to the SEC regarding CBOE's proposed rule change, the CBOT never contended that the SEC lacked jurisdiction, under the SEA, to regulate trading in GNMA options.[34] Indeed the CBOT comments implicitly acknowledge the SEC's jurisdiction. *See* SEC Record 473-89, 530. Since the CBOT has sought review in this court pursuant to section 78y of the SEA, its failure to object to SEC jurisdiction before that agency should be fatal to any such consideration here. *Sartain v. Securities and Exchange Comm.*, 601 F.2d 1366, 1371-72 (9th Cir. 1979); *Berdahl v. Securities and Exchange Comm.*, 572 F.2d 643, 648-49 (8th Cir. 1978).

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[33] *continued*

> banks and other financial institutions, *is unnecessary unless executed on a formally organized futures exchange.*

Ante at 36-37 n.34, *quoting* 1974 Senate Report at 23, *reprinted in* [1974] U.S. Code Cong. & Ad. News 5863-64 (emphasis added).

[34] Nor did the CFTC raise this argument in its comments to the SEC. *See* SEC Record 630-41.

In any event, despite the strenuous labors of the majority to establish the quite novel proposition that the SEC is without jurisdiction to regulate the trading of GNMA options on a national securities exchange, this thesis simply cannot withstand analysis. Essentially the majority argues that an option to buy or sell GNMA's is not a "security" as defined in the Securities and Exchange Act. But the instruments on which the CBOE proposes to trade options are certainly securities evidencing an interest in a pool of federally-insured mortgages. *See Davidson v. Dean Witter Reynolds, Inc.*, 478 F. Supp. 494, 495 (D. Colo. 1979). Section 3(a)(10) of the SEA, 15 U.S.C. § 78c(a)(10) (1976), provides that the term "security" includes "any note, . . . bond, [or] debenture . . .," and GNMA's fall squarely within this definition. By virtue of the guarantee by GNMA of timely payment of interest and principal, backed by the full faith and credit of the United States government, GNMA certificates are also within the definition of "exempted securities" in section 3(a)(12) of the SEA, 15 U.S.C. § 78c(a)(12) (1976).

Although it is true that the SEC does not have regulatory authority over the *registration* of "exempted securities," and that a number of provisions of the SEA do not apply to them, the SEC does possess considerable authority over the *trading* of exempted securities. Thus, the provisions of the SEA which authorize the SEC to regulate trading on national securities exchanges apply to *all* securities, including exempted securities such as GNMAs. *See* 15 U.S.C. § 78e (unlawful "to effect any transaction in a security" on an unregulated exchange); 15 U.S.C. § 78k(a) (regulation of "any transaction" on an exchange by its members); 15 U.S.C. § 78k(b) (regulation of exchange specialists and odd lot dealers); 15 U.S.C. § 78s(b)(c) (SEC power to review, abrogate, or amend exchange rules). Moreover, the general antifraud provisions of the SEA apply to the purchase or sale of "any" security, whether the transaction is effected on an exchange or in the over-the-counter market. SEA §§ 10(b), 15(c)(1); 15 U.S.C. §§ 78j(b),

78o(c)(1) (1976).[35] Indeed, the SEC has been actively involved in enforcing the anti-fraud provisions of the SEA in connection with the trading of exempted securities, including over-the-counter trading in GNMAs and optional GNMA standbys.[36] Since GNMA options are contracts to buy or sell GNMA securities, and since the SEC has extensive jurisdiction to regulate the trading of exempted securities, these factors alone strongly support SEC authority to approve the CBOE's proposed GNMA options program. *See Blue Chip Stamps v. Manor Drug Store*, 421 U.S. 723 (1975).

Not only does the SEC have the statutory authority to regulate the trading of exempted securities, it has exercised (and is currently exercising) that authority. Exempted securities are listed and traded on several national securities exchanges,[37] and those exchanges have adopted specific rules relating to the trading of exempted securities.[38] The SEC has plenary authority over

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[35] This result is sensible from a regulatory viewpoint since unscrupulous dealers may engage in fraudulent selling practices involving government-related securities even though the securities themselves are sound. *See* SEC Record 470-71. As GNMA itself recently noted, "[w]hile the integrity of the [GNMA] securities is absolutely sound, abuses in the way in which the securities are sold, financed, and traded" have occurred. 45 Fed. Reg. 40,556 (1980).

[36] *See, e.g., SEC v. G. Weeks Securities, Inc.*, 483 F. Supp. 1239 (W.D. Tenn. 1980); *SEC v. Harwell*, SEC Lit. Rel. No. 8559 (1978); *SEC v. Winters Gov't Sec. Corp.*, SEC Lit. Rel. No. 8202 (1977); *In re Merrill Lynch, Pierce, Fenner & Smith*, SEA Rel. No. 11515, *reprinted in* [1975-1976 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶80,216 (1975).

[37] *See* 1 Am. Stock Ex. Guide (CCH) 1401-09 (1979) (U.S. Government notes, bonds and bills); 1 NYSE Guide (CCH) 899-57 to 60 (1981) (U.S. Government bonds and notes); PHLX Guide (CCH) 776 (1981) (GNMA securities).

[38] *See* Rules 120, 140, 2 Am. Stock Ex. Guide (CCH) ¶¶9270, 9288 (1981); Rules 62.10, 66, 2 NYSE Guide (CCH) ¶¶2062, 2066 (1978); Rules 150-54, PHLX Guide (CCH) ¶¶2150-54 (1977).

the adoption and amendment of such rules, and it has consistently and carefully exercised that authority.[39]

In addition, the GNMA options to be traded on the CBOE are themselves securities. Such options clearly fall within the statutory definition of "any instrument commonly known as a 'security.'" *See* I L. Loss, Securities Regulation 469 (2d ed. 1961). Moreover, the definition of security in section 3(a)(10) of the Securities Exchange Act expressly encompasses any "warrant or right to subscribe to or purchase" any security, which the courts have consistently construed to include "call" options on securities. *See, e.g., Blue Chip Stamps v. Manor Drug Store*, 421 U.S. 723, 750-51 (1975); *Mansbach v. Prescott, Ball & Turben*, 598 F.2d 1017, 1026 n.40 (6th Cir. 1979); *Lutgert v. Vanderbilt Bank*, 508 F.2d 1035, 1038 (5th Cir. 1975); *Lloyd v. Industrial Bio-Test Laboratories, Inc.*, 454 F. Supp. 807, 810-11 (S.D.N.Y. 1978).

By the same token, "put" options—the writers of which undertake a contractual obligation to buy an underlying security upon exercise by the option holder—

[39] For example, when the American Stock Exchange ("Amex") recently wished to amend its rules in order to trade GNMA securities, it was required to submit the proposed rules changes to the SEC for review pursuant to section 19(b) of the SEA. The SEC approved the rules changes after finding them to be consistent with the requirements of the SEA, particularly section 6 and the rules and regulations thereunder. 44 Fed. Reg. 50,942 (1979). In 1977, when the Amex and the CBOE filed separate proposals for instituting options trading on Government debt securities, the SEC exercised its regulatory authority by determining not to approve such proposals until after completion of a special study of the options market which the SEC had undertaken. 42 Fed. Reg. 56,711 (1977). Although the SEC published notice of these 1977 proposals, 42 Fed. Reg. 2734 (1977) (Amex) and 42 Fed. Reg. 32,236 (1977) (CBOE), no comments were filed suggesting either that the SEC lacked jurisdiction to authorize options trading on Government debt securities on a national security exchange, or that such trading was subject to the jurisdiction of the CFTC.

have a similar status as securities under the Securities Exchange Act. Sections 3(a)(13) and 3(a)(14) of that Act define the "purchase" and "sale" of a security to include, respectively, "any contract to buy, purchase or otherwise acquire" and "any contract to sell or otherwise dispose of." As the Supreme Court has explained,

> the holders of *puts*, calls, options and other contractual rights or duties to purchase or sell securities have been recognized as "purchasers" or "sellers" of securities * * * because the definitional provisions of the 1934 Act themselves grant them that status.

Blue Chip Stamps v. Manor Drug Store, 421 U.S. 723, 751 (1975) (emphasis supplied). Moreover, lower courts and commentators have consistently indicated that both put and call options on securities fall within the broad definition of securities under section 3(a)(10) of the SEA. *Mansbach v. Prescott, Ball & Turben*, 598 F.2d 1017, 1026 n.40 (6th Cir. 1979) (definition of security in section 3 of SEA "clearly includes options to purchase or sell stock"); *Savino v. E.F. Hutton & Co.*, 507 F. Supp. 1225, 1235 (S.D.N.Y. 1981) (stock options purchased and sold by defendants "undoubtedly constituted 'securities' within the meaning of the federal securities' laws"); *Globus, Inc. v. Jaroff*, 271 F.Supp. 378, 380 (S.D.N.Y. 1967) ("It is axiomatic . . . that an option agreement is a security under the 1934 Act"); I L. Loss, Securities Regulation 469 (2d ed. 1961) (both put and call options are subsumed under "interest or instrument commonly known as 'security'" in statutory definition). *See also* SEC Rule 3a11-1, 17 C.F.R. § 240.3a11-1 (1980) (defining the term "equity security" as including "any put, call, straddle, or other option or privilege").

Common sense strongly suggests that an option to buy or sell an interest in a pool of mortgages (traditional "securities" of impeccable credentials) must be a security by any reasonable test. I see no reason to pursue the question (which the majority harries around every twist and turn) whether options on GNMAs are "investment contract" securities (contemplating investment in a common enterprise with an expectation of profits). The essential flaw in the majority's analysis at this point is

its failure to distinguish between options (and other transactions) relating to non-security commodities, which transactions may or may not qualify as "investment contract securities" for purposes of the SEA, and options on financial instruments such as GNMAs, in which the underlying "commodity" is incontestably a "security" within the meaning of the Securities Acts.

The majority's reliance on *Teamsters v. Daniel*, 439 U.S. 551 (1979) and *Marine Bank v. Weaver*, 50 U.S.L.W. 4285 (Supreme Court, March 8, 1982), to support the proposition that "the context requires the GNMA options are not securities" is similarly misplaced. In both *Daniel* and *Weaver*, the question before the Supreme Court was whether certain "non-market" financial interests fell within the definition of a "security" under the SEA.[40] In the instant case, unlike *Daniel* and *Weaver*,

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[40] In *Daniel*, the interest at issue was an employee's share in "a noncontributory compulsory pension plan," 439 U.S. at 553, while in *Weaver*, the disputed instruments were "a conventional certificate of deposit and a business agreement between two families." 50 U.S.L.W. at 4285. The Supreme Court in *Weaver* expressly reemphasized the broad scope of the definition of "security" found in § 3(a)(10) of the SEA, and stated that the term "was meant to include 'the many types of instruments that in our commercial world fall within the ordinary conception of a security.'" 50 U.S.L.W. at 4286 *quoting* H.R. Rep. No. 85, 73d Cong., 1st Sess. 11 (1933). The Supreme Court in *Weaver* also reaffirmed its holding in *SEC v. Howey, Inc.*, 328 U.S. 293, 299 (1974), that the definition of security "includes [not only] ordinary stocks and bonds, [but also] the 'countless and various schemes' devised by those who seek the use of the money of others in the promise of profits." 50 U.S.L.W. at 4286. The *Weaver* Court concluded, however, that *in the particular fact situation before it, see* 50 U.S.L.W. at 4288 n.11, it was "unnecessary to subject issuers of bank certificates of deposit to liability under the federal securities laws since the holders of bank certificates of deposit are abundantly protected under the federal banking laws." 50 U.S.L.W. at 4287.

there is no doubt that the *underlying* instrument—a GNMA—is itself a "security." The only question is whether a particular derivative of that instrument—a GNMA option—is equally a security. Hence, in the present case, unlike *Daniel* and *Weaver*, where the share of the pension plan and the bank certificate of deposit, respectively, were not derived from an admitted "security," we are concerned with something that is, at the very least, intimately tied to securities trading. One might well call one's broker to trade a GNMA option but surely not a pension plan share or a certificate of deposit.[41]

In addition, in both *Daniel* and *Weaver* the Supreme Court relied heavily on the presence of an alternative "comprehensive" regulatory framework, governing the precise interest or instrument over which the SEC was attempting to assert jurisdiction. In the instant case, by contrast, as the majority itself points out, the "alternative" system of regulation has, in fact, authorized only the trading of GNMA futures and options on such futures; it does not purport to regulate options trading in the underlying GNMAs. *See ante* at 13-15 & nn.13, 15. Indeed by its transmittal to Congress of proposed Exemptive Rule 34.1, the CFTC has indicated that it has neither the expertise nor the desire to regulate the trading of GNMA options on a national securities exchange. *See* note 30 *supra*. The "contextual" analysis employed by the Supreme Court in *Daniel* and *Weaver* is thus of little relevance to the instant case.

V.

Having determined that trading in GNMA options does not fall within the exclusive jurisdiction of the CFTC, and that both GNMAs and GNMA options are clearly "securities" within the meaning of the SEA, the final question to be considered is whether sections 4c(b) and 4c(c) of the CEA give the CFTC the power to ban

[41] I understand there is some exchange trading of *futures* on bank certificates of deposit.

the trading of GNMA options on a national security exchange. By the majority's own logic, the answer must be "No." The SEA "Savings Clause" contained in CEA § 2(a)(1) states that "except as hereinabove provided, nothing contained in this section shall [limit the jurisdiction of the SEC]." The language "hereinabove provided" refers specifically to the CFTC's exclusive jurisdiction clause and does not include the broad definition of "commodity" found in § 2(a)(1). *See ante* at 16. Since the definition of "commodity" is "in this section" but not "hereinabove provided," that definition cannot limit SEC jurisdiction. Thus, the expanded definition of commodity, which is incorporated in §§ 4c(b) and 4c(c), cannot be used to invalidate the SEC rule at issue here.

I could be content with this logic (favored by the majority), which shuts the door tight on the CFTC. Alternatively, one could reach the same result via a plain-language interpretation of the Treasury Amendment. *See* pp. 84-86 *supra*. But even if we were to forego the majority's logic, and recognize the application of §§ 4c(b) and 4c(c) to the instant problem, we would come out at the same place as a practical matter. The CFTC has now carried out the mandate of these sections by authorizing the SEC to regulate options trading on the CBOE and other security exchanges. On February 19, 1982, pursuant to its authority under sections 4c(b), 4c(c), and 8a(5)[42] of the CEA, the CFTC submitted to Congress Proposed Rule 34.1 which, "if adopted, would exempt from the prohibition of section 4c(c) and from Parts 32 and 33 of the [CFTC] Regulations, any transactions in an option on exempted securities, certificates of deposit, and foreign currency if conducted on a national securities exchange registered with and regu-

[42] CEA § 8a(5), 7 U.S.C.A. § 12a(5) (1980), gives the CFTC the authority "to make and promulgate such rules and regulations as, in the judgment of the Commission, are reasonably necessary to effectuate any of the provisions or to accomplish any of the purposes of this chapter."

lated by the SEC."[48] Thus, if the CFTC has concurrent jurisdiction over trading in GNMA options by virtue of

[48] 47 Fed. Reg. 7677, 7678 (Feb. 22, 1982) (emphasis added). Despite the CFTC's express statement that Proposed Rule 34.1 "would remove any possibility that the prohibitions in Section 4(c) . . . would impede trading in options on exempted securities on national securities exchanges subject to regulation by the SEC," 47 Fed. Reg. at 7678 n.2, the majority argues that the proposed CFTC rule, even if approved by Congress, would not lift the options ban. *Ante* at 13-14 n.13. The apparent basis for this argument is the majority's view that the proposed rule does not adequately "document the CFTC's ability to regulate options on exempted securities." *Id.* at 14 n.13. In light of the extensive evidence documenting the *SEC's* ability to regulate GNMA options trading, *see* note 13 *supra*, and the express provisions of the CEA directing the CFTC and the SEC to consult and cooperate on jurisdictional matters, *see* 7 U.S.C. § 4a(g)(2), the majority's view represents an extremely crabbed interpretation of section 4c(c)—an interpretation that is strikingly at odds with the majority's expansive notions of CFTC authority under other sections of the CEA.

In any event, the submission to Congress of CFTC Proposed Rule 34.1, in conjunction with the recent jurisdictional agreement reached between the SEC and the CFTC, raises serious mootness and standing problems in the instant case. *See generally Simon v. Eastern Kentucky Welfare Rights Organization*, 426 U.S. 26, 37-39 (1976); *Warth v. Seldin*, 422 U.S. 490, 498-99 (1975). Although the CBOT has asserted standing both on its own and as representative of its members, it is difficult to understand how either the Board of Trade *or* its individual members will be injured by the SEC's decision to authorize the trading of GNMA *options* on a totally independent *securities* exchange. Indeed, because the options pilot program recently enacted by the CFTC "is limited to options on commodity futures," *ante* at 13 n.13, *quoting* 46 Fed. Reg. 54,530 (Nov. 3, 1981), the CBOE and the CBOT would not even be competing for the same trading business. *Cf. Association of Data Processing Service Organizations v. Camp*, 397 U.S. 150, 152-53 (1970). Moreover, Article V of the CBOE's Certificate of Incorporation provides that all present and future members of the Board of Trade may become members of the CBOE without the purchase of a seat, and a number of Board of Trade members have exercised this right. Such a

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§ 4c(b) or 4c(c), it has exercised that jurisdiction to clear the way for SEC regulation.

VI.

During oral argument of this case, Judge Campbell announced in no uncertain terms his view that, instead of cluttering the docket of this court, the SEC and the CFTC should carry out their statutory mandate to resolve among themselves any jurisdictional conflicts. They have now resolved their differences in a way which is consistent with almost any decision by us *except* the strained conclusion of the majority that the CFTC has exclusive jurisdiction and the SEC is wholly without jurisdiction to regulate the trading of GNMA options. Not only have we done our best to frustrate the efforts of the concerned regulatory agencies at compromise, but we have managed to conclude that an agency of long experience and high reputation must fully abandon its field of expertise in favor of a new and relatively untested regulatory body of uncertain prospects.[44] As a practical matter, we have determined that

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[43] *continued*
dual membership provision further reduces the already attenuated potential for injury to CBOT members resulting from the trading of GNMA options on the CBOE.

The majority's citation of *Hill v. Wallace*, 259 U.S. 44, 61 (1922), *ante* at 6 n.4, to support the standing of the Board of Trade is not persuasive. The statute challenged in *Hill* imposed a confiscatory tax of 20 cents a bushel on all grain futures contracts then traded on the Chicago Board of Trade. Plaintiffs in *Hill* (who did not include the Board of Trade itself) specifically alleged that "no member of the Board could afford to make contracts for future delivery and pay the tax thereon," and that "the [challenged] law in effect prohibits all [Board of Trade members] from making any contracts of sale for future delivery." 259 U.S. at 47. The contrast between the direct and immediate injury alleged in *Hill* and the merely abstract potential for harm alleged by the Board of Trade in the instant case could hardly be more distinct.

[44] The CFTC's regulatory authority is due to expire on September 30, 1982. 7 U.S.C.A. § 16(d) (1980). Currently,

(Footnote continued on following page)

the jurisdiction of the SEC is frozen and capped, and that the regulation of options trading on a host of newly developing security/commodities will fall to the exclusive jurisdiction of the CFTC.[45] Perhaps all of this will have a happy ending (and a warm reception from Congress). My own surmise is that the strained analysis of the majority will gain no more attractive practical result in the real world than it has achieved conceptual triumph in the world of theory.

I therefore respectfully dissent.

A true Copy:

Teste:

Clerk of the United States Court of Appeals for the Seventh Circuit

[44] *continued*
Congressional subcommittees in both the Senate and House are holding hearings to determine whether such authority should be renewed. Testimony given at these hearings has highlighted the CFTC's present inability to effectively police abuses in the commodities industry. In light of these enforcement problems, several congressional witnesses, including the current Chairman of the CFTC, have suggested that the CEA's exclusive jurisdiction proviso be modified to give state agencies and other federal authorities concurrent jurisdiction over the policing of commodities fraud. *See Chicago Tribune*, Feb. 24, 1982, § 2 (Business) at 1 (quoting testimony of CFTC Chairman Phillip Johnson and Senator William V. Roth, Jr.). Similar proposals have been endorsed by the General Accounting Office, Congress' investigative arm, which recently completed a highly critical study of the CFTC. *Id.*

[45] Such a determination, of course, runs directly counter to the oft repeated pronouncements of both the Supreme Court and this circuit that the provisions of the SEA (including the definition of a security) are to be liberally construed in order to carry out the broad remedial purposes of the Securities Acts. *See, e.g., Tcherepin v. Knight*, 389 U.S. 332 (1967); *Canadian Import Bank of Commerce Trust Co. v. Fingland*, 615 F.2d 465 (7th Cir. 1980); *Goodman v. Epstein*, 582 F.2d 388 (7th Cir. 1978), *cert. denied*, 440 U.S. 939 (1979).

USCA 5730—Midwest Law Printing Co., Inc., Chicago—3-24-82—450

In the

United States Court of Appeals

For the Seventh Circuit

Chicago, Illinois 60604
Submitted: March 5, 1982
March 24, 1982

Before

Hon. WALTER J. CUMMINGS, *Chief Judge*

Hon. RICHARD D. CUDAHY, *Circuit Judge*

Hon. WILLIAM J. CAMPBELL, *Senior District Judge**

No. 81-2587
BOARD OF TRADE OF THE CITY OF CHICAGO,
Petitioner,

v.

SECURITIES AND EXCHANGE COMMISSION,
Respondent,

THE OPTIONS CLEARING CORPORATION,
Intervenor-Respondent,

CHICAGO BOARD OPTIONS EXCHANGE, INC.,
Intervenor-Respondent.

On Petition for Review of an Order of the
Securities and Exchange Commission.

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* The Honorable William J. Campbell, Senior District Judge for the Northern District of Illinois, is sitting by designation.

ORDER

This is the second of three related petitions for review of Securities and Exchange Commission (SEC) orders regarding options trading. The Board of Trade of the City of Chicago (Board of Trade) filed the first petition, our No. 81-1660, asking this Court to set aside an SEC order that approved rule changes on the Chicago Board Options Exchange, Inc. (CBOE) needed to begin trading on the CBOE of options on Government National Mortgage Association mortgage-backed pass-through certificates (GNMA's). The Board of Trade filed the petition in the present case to have us set aside an August 6, 1981, SEC order approving rule changes of the Options Clearing Corporation, Inc. (OCC) necessary for the OCC to issue, clear, and settle GNMA options traded on national securities exchanges.[1] As in its first petition, the Board of Trade claims here that the rule changes would violate various provisions of the Commodity Exchange Act (CEA) and that the SEC is without power under the Securities Exchange Act of 1934 (SEA) to approve such changes.[2] The third petition, No. 82-1097, was filed by the Board of Trade and the Chicago Mercantile Exchange to review an SEC order approving rule changes of the CBOE and American Stock Exchange that would allow trading on the latter of off-set options contracts in Treasury bonds, notes, and bills. We denied motions to consolidate these cases, but have asked the parties to limit their briefs in this case and No. 82-1097 to issues not briefed and argued in No. 81-1660.

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[1] The OCC is presently the issuer of and serves as the clearing agency for other types of put and call options that may be purchased and sold in transactions on certain national securities exchanges including the CBOE.

[2] Both contentions were raised to the SEC by the Board of Trade during the notice and comment period prior to the SEC approval of the rule changes. 8-6-81 SEC Order pp. 1-2 n. 2. Thus there is no question (as there was in No. 81-1660) whether the Board of Trade waived its objections to the rule changes.

We have granted the Board of Trade's first petition in an opinion released today in our No. 81-1660. After considering the briefs filed in the present case by the petitioner Board of Trade, respondent SEC, and intervenor respondents OCC and CBOE, we have decided that oral argument is unnecessary herein and that the differences between this petition and the petition in No. 81-1660 are insignificant. Therefore we grant the Board of Trade's petition and set aside the SEC order in the present case also.

There are essentially only two issues presented by the instant petition that were not resolved by our decision in No. 81-1660.[3] The first is whether the options ban of Section 4c(c) of the CEA, 7 U.S.C. §6c(c), applies to the OCC's proposed activity regarding GNMA options. At present, Section 4c(c) provides that "no person may * * * offer to enter into, enter into, or confirm the execution of" a GNMA option transaction. Since the OCC rule changes would allow it to "enter into" GNMA options transactions by issuing (writing) the GNMA options, 8-6-81 SEC Order p. 3, the options ban applies.[4] Indeed, the SEC in its brief herein (p. 1) states that the OCC rule changes "are necessary to facilitate the listing and trading of GNMA options on the CBOE." Since the latter were held unlawful in No. 81-1660, the result can be no different here.

The second new issue is whether Section 17A of the SEA, 15 U.S.C. §78q-1, gives the SEC power to approve the OCC's rule changes for GNMA options trading. (We held in No. 81-1660 that the SEC has no power under other Sections of

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[3] See our opinion in No. 81-1660 for a full discussion of the factual background and common legal issues.

[4] The OCC's GNMA Put and Call Options Prospectus Supplement, contained in Addendum D to its brief, does not presently violate the options ban as an "offer to enter into" GNMA options transactions since it is conditioned upon a favorable outcome to this litigation. The outcome being unfavorable, there is no offer.

the SEA to authorize GNMA options trading on the CBOE.) Section 17A was passed in the 1975 amendments to the SEA primarily for the purpose of effecting "[t]he prompt and accurate clearance and settlement of *securities* transactions * * *." SEA §17A(a)(1)(A), 15 U.S.C. §78q-1(a)(1)(A) (emphasis added). Among other things, Section 17A allows the SEC to require registration of and promulgate rules governing "clearing agencies," such as the OCC. SEA §17A(b) and (d), 15 U.S.C. §78q-1(b) and (d). Registration, however, is limited to clearing agencies "perform[ing] the functions of a clearing agency *with respect to any security* (other than an exempted security). "SEA §17A(b)(1), 15 U.S.C. §78q-1(b)(1) (emphasis added). Since we held in No. 81-1660 that exchange-formed off-set options on GNMA's are not securities within the purview of the SEA, the SEC's registration powers over clearing agencies do not reach the OCC rule changes. The SEC's general rule-making powers regarding registered clearing agencies extend to those agencies "directly or indirectly[ ] engage[d] in any activity as [a] clearing agency * * *." SEA §17A(d)(1), 15 U.S.C. §78q-1(d)(1). But the "activity" of a clearing agency is limited to the handling of securities; in general, "[t]he term 'clearing agency' means any person who acts as an intermediary in making payments or deliveries in connection with *transactions in securities* or who provides facilities for comparison of data respecting the terms of settlement of *securities transactions*, to reduce the number of settlements of *securities transactions*, or for the allocation of *securities* settlement responsibilities." SEA §3(a)(23)(A), 15 U.S.C. §78c(a)(23)(A) (emphasis added). Therefore, Section 17A does not give the SEC power over GNMA Options trading beyond what we found in No. 81-1660, and the SEC's approval of the OCC rule changes is not "consistent with the requirements of" the SEA as required by SEA §19(b)(2), 15 U.S.C. §78s(b)(2). The SEC's power primarily regards the trading of securities, and the OCC has proposed trading in instruments we have held are not securities.

Accordingly, the SEC order of August 6, 1981, is set aside. Our mandate shall issue forthwith, with costs to be taxed to respondents.

Cudahy, *Circuit Judge*, dissenting: For the reasons set forth in my dissenting opinion in *Board of Trade of the City of Chicago v. Securities and Exchange Commission, et al.*, No. 81-1660, I respectfully dissent.

UNITED STATES OF AMERICA

before the

SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Release No. 17577 / February 26, 1981
In the Matter of
Chicago Board Options Exchange, Incorporated
LaSalle at Jackson
Chicago, Illinois 60604

(File No. SR-CBOE-80-7)

ORDER APPROVING AMENDED PROPOSED RULE CHANGE

On April 17, 1980, the Chicago Board Options Exchange, Incorporated (the "CBOE") filed with the Commission, pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the "Act"), 15 U.S.C. 78s(b)(1), and Rule 19b-4 thereunder, copies of a proposed rule change that would modify CBOE rules to provide for exchange trading of standardized options contracts on mortgage pass-through certificates guaranteed by the Government National Mortgage Association ("GNMAs," "GNMA certificates," or "GNMA securities").[1] In order to assist in its analysis of the CBOE proposal, the Commission, on July 24, 1980, published a release extending the time for the submission of public comments and requesting comments concerning a number of particular features of the proposed options contract and of the market and

[1] Notice of the filing of the proposed rule change was given by Securities Exchange Act Release No. 16801 (May 12, 1980) (45 FR 32458 (1980)).

regulatory environment within which it would be traded.[2] On December 19, 1980, the CBOE filed amendments to its proposal which, among other things, would establish premium-based margin requirements for GNMA options, eliminate the limit order book for such options, and broaden the market maker spread parameters.[3]

I. INTRODUCTION

The CBOE proposal would modify its rules to permit the trading of standardized put and call options on GNMA modified pass-through certificates.[4] Timely payment of interest and principal on GNMA securities is guaranteed by GNMA, and that guarantee is backed by the full faith and credit of the United States government. The CBOE proposal would provide the first exchange-based GNMA options trading, although optional forward contracts ("stand-bys") are currently traded in the over-the-counter market.[5] In addition, standardized contracts for future delivery of GNMA certificates are traded on boards of trade subject to the regulatory oversight of the Commodity Futures Trading Commission (the "CFTC").

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[2] Securities Exchange Act Release No. 17005 (45 FR 51016 (1980)).

[3] Notice of the filing of the amended proposed rule change was given by Securities Exchange Act Release No. 17413 (January 5, 1981) (46 FR 2439 (1981)).

[4] Each GNMA certificate represents an interest in a pool of mortgages insured by the Farmers Home Administration or the Federal Housing Administration or guaranteed or insured by the Veterans Administration.

[5] In addition to transactions for immediate delivery, the GNMA over-the-counter markets include both optional and mandatory forward commitments. An optional forward commitment is a contract that permits, but does not obligate, the purchaser to deliver GNMA securities on a specified date according to prearranged terms. A mandatory forward commitment obligates the parties to make and take delivery on a specific future date according to prearranged terms.

The CBOE proposes to trade puts and calls on GNMA securities with $100,000 remaining principal balance.[6] The GNMA options contract would be traded on the basis of a GNMA certificate bearing a nominal 8 percent coupon rate. The terms of the contract would permit delivery of GNMA certificates bearing a range of GNMA coupons, with a price adjustment to provide a yield equivalent to delivery of a certificate with a nominal coupon. This yield equivalence concept is similar to delivery practices in the current over-the-counter optional and mandatory GNMA forward markets and is also used in the GNMA futures markets. In an effort to promote delivery by issuers[7] of their current production, GNMA coupons eligible for delivery generally would be restricted to certificates bearing coupon rates at, or lower than, the current production rate.[8]

II. DISCUSSION

In its filing, the CBOE argued that the public interest would be advanced by Commission approval of CBOE's proposal to trade GNMA options.[9] In support of this

[6] Delivery of GNMA certificates with a remaining principal balance less that 2.5 percent above or below the contract amount would be permitted. This would conform with current practice in the cash market.

[7] GNMA securities are currently issued by about 900 private firms that originate mortgages. Approximately two-thirds of these firms are mortgage bankers; the remainder are largely commercial banks and savings and loan associations. See, *Report of the Joint Treasury-SEC-Federal Reserve Study of the Government-Related Securities Markets*, S. Rep., 96th Cong., 2d Sess. (Comm. Print 1980) ("GNMA Study"), at p. 34.

[8] Because the current production rate is the highest deliverable rate, it normally will be the optimal delivery. See, CBOE, *A Market in Options on GNMA Modified Pass-Through Securities* [undated] ("CBOE GNMA Options Memorandum"), at pp. 25-27. In the event of a change in the GNMA production rate, specific delivery provisions would encourage, for a limited period, the delivery of mortgage production still in the pipeline.

[9] File No. SR-CBOE-80-7.

contention the CBOE has argued that optional contracts providing for delivery of GNMAs are of substantial economic importance to the GNMA market and the housing industry generally.[10] Although the problems that have characterized the over the-counter markets for such contracts have limited the availability of stand-bys,[11] the CBOE asserts that the creation of an exchange market for GNMA options would alleviate these problems, thereby supporting the basic economic function of the GNMA markets—increased capital formation in the housing industry through access to the capital markets for loanable funds. Moreover, the CBOE asserts that exchange trading of GNMA options also would increase the usefulness of an optional delivery instrument to GNMA market participants through standardization of contract and delivery terms and increased efficiency.

The Commission received 85 comment letters concerning the CBOE proposal,[12] all but one of which were essentially supportive.[13] The majority of letters were received from

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[10] CBOE GNMA Options Memorandum, at p. 3.

[11] For a discussion of the problems and abuses which developed in the GNMA markets, *see*, GNMA Study. See also letter dated June 20, 1980, from Alan E. Rothenberg, Senior Vice President, Citizens Savings and Loan Association, to the Secretary of the Commission; letter dated July 10, 1980, from William E. Long, Vice President, Residential Division, Percy Wilson Mortgage and Finance Corp., to George A. Fitzsimmons, Secretary of the Commission. File No. SR-CBOE-80-7.

[12] The Commission has considered all comment letters received and has placed them in a public file. See File No. SR-CBOE-80-7.

[13] The Chicago Board of Trade (the "CBT") argued, in general, that the CBOE's proposed GNMA options are within the jurisdiction of the CFTC and that, therefore, the current proscription of commodity options, pursuant to the Commodity Exchange Act (the "CEA"), 7 U.S.C. 1 *et seq.*, and the rules and regulations thereunder, applies to the CBOE proposal. Letter dated August 26, 1980, from Robert K. Wilmouth, President, Chicago Board of Trade, to George A. Fitzsimmons, Secretary of the

(footnote continued)

mortgage bankers and strongly supported the prompt development of exchange trading in standardized GNMA options. These commentators stated that the availability of such options would facilitate their activities in the housing market, while at the same time avoiding the problems associated with the existence of abuses in the over-the-counter stand-by market.[14] Similar views were expressed by other firms doing business with mortgage bankers and/or in the markets for GNMA securities, as well as by the Options Committee of the Securities Industry Association.[15]

In order to assist in its analysis of the CBOE proposal, the Commission staff solicited specific comments from several governmental agencies[16] in an effort to determine the extent to which their interests might be affected by the development of an exchange-based standardized GNMA options market.

(footnote continued)

Commission ("CBT letter"). The Commission disagrees. We believe that the CEA is not applicable to the trading of options on GNMA securities, particularly where the trading is on a national securities exchange. *See Section 2(a)(1) of the Commodity Exchange Act, 7 U.S.C. 2. See also Report of the Senate Comm. on Agriculture and Forestry on H. R. 13113, S. Rep., No. 1131,* 93d Cong., 2d Sess. (1974) at p. 26.

[14] In addition to comments from individual mortgage bankers, the Mortgage Bankers Association and the Mortgage Backed Securities Division of the Public Securities Association endorsed the CBOE proposal. Those organizations also made several more technical comments, which are discussed *infra.*

[15] Letter dated November 3, 1980, from John Fitzgerald, Chairman, Options Committee, Securities Industry Association, to George Fitzsimmons, Secretary of the Commission.

[16] The Commission staff requested comments from GNMA, the Department of the Treasury, the Commodity Futures Trading Commission, the Board of Governors of the Federal Reserve System, and the Federal Reserve Bank of New York.

In response, the Commission received six letters,[17] all of which indicated general support for the CBOE proposal.[18]

GNMA and the Department of Housing and Urban Development strongly endorsed the establishment of a regulated market for the trading of optional delivery contracts on GNMA securities, and indicated that such a market would enhance the ability of GNMA to fulfill its responsibilities to the housing market. The Federal Reserve Bank of New York ("FRB-NY") observed that it was unlikely that the trading of standardized GNMA options would have an impact on the market for related underlying securities, such as Treasury bonds, and indicated that the over-the-counter GNMA forward market could have a more significant effect on the market for Treasury securities, in light of the possibility that overextensions and defaults in that market could threaten the financial integrity of firms also making markets in Treasury securities. The staff of the Board of Governors of the Federal Reserve System (the "FRB") and the Department of the Treasury suggested that, on balance, it appeared likely

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[17] Letter dated August 26, 1980, from Ronald P. Laurent, President, Government National Mortgage Association, Department of Housing and Urban Development, to Douglas Scarff, Director, Division of Market Regulation ("GNMA letter"); letter dated September 8, 1980, from Lawrence B. Simons, Assistant Secretary for Housing—Federal Housing Commissioner, to Douglas Scarff, ("HUD letter"); letter dated September 11, 1980, from Robert Carswell, Deputy Secretary of the Treasury, to Douglas Scarff, ("Treasury letter"); letter dated September 17, 1980, from Peter D. Sternlight, Senior Vice President, Federal Reserve Bank of New York, to Douglas Scarff, ("FRB-NY letter"); letter dated November 5, 1980, from Stephen H. Axilrod, Staff Director for Monetary and Financial Policy, Board of Governors of the Federal Reserve System, to Douglas Scarff, ("FRB letter"); and letter dated February 10, 1981, from James A. Culver, Director, Division of Economics and Education, CFTC, to Douglas Scarff ("CFTC letter"). File No. SR-CBOE-80-7.

[18] While the CFTC letter did not explicitly endorse the CBOE proposal and indicated that it would not address issues with respect to the Commission's jurisdiction over GNMA options, it did not raise any problems with the concept of exchange-traded options on GNMA securities.

that the existence of a derivative options market would benefit the GNMA cash market, and concluded that a GNMA options market, if properly regulated, would not be expected to have adverse effects on the markets for Treasury securities.

A. *Contract design.*

The American Stock Exchange, Inc. (the "Amex"), although generally supporting the concept of exchange-traded options on GNMAs, expressed concern regarding the design of the CBOE's proposed contract and asserted that the CBOE proposal does not adequately address market needs.[19] Essentially, the Amex stated that the yield equivalence feature of the CBOE contract would create uncertainty as to what coupon rate would be borne by GNMA securities delivered upon exercise of an option, and that, consequently, an options contract for each GNMA coupon rate would be preferable.[20] As discussed, *infra*, so long as there are not regulatory concerns, the Commission is not inclined to substitute its judgment for that of a self-regulatory organization with respect to such matters of business judgment as the optimal contract design for trading standardized options on GNMA securities. Under these circumstances, the marketplace generally should be permitted to determine whether a particular contract meets the needs of market participants.

B. *Sales practice requirements.*

Several commentators indicated that a major benefit of the CBOE proposal would be the availability of a GNMA options market subject to an effective regulatory structure.[21] In this

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[19] Letter dated August 20, 1980, from Paul G. Stevens, Senior Vice President, Options Division, Amex, to George A. Fitzsimmons, Secretary of the Commission ("Amex letter").

[20] On December 23, 1980, the CBOE addressed in detail the issues raised in the Amex letter and provided reasons for CBOE's choice of delivery requirements. See letter dated December 23, 1980, from Thomas N. Rzepski, Senior Vice President, Research and Planning, CBOE, to George A. Fitzsimmons, Secretary of the Commission. Other commentators indicated that permitting delivery of a range of coupon rates would be desirable in certain respects. See, *e.g.*, FRB letter, GNMA letter.

[21] See, *e.g.*, Treasury letter, FRB-NY letter, GNMA letter.

regard, the CBOE would apply its existing options sales practice rules to the trading of GNMA options. For example, the strict suitability rules for equity options customers, adopted by the CBOE in response to the Options Study recommendations,[22] would also be applicable to GNMA options customers. In addition, customer accounts would be required to be specifically approved for GNMA options trading based on the customer's background and financial information and investment objectives.[23] Broker-dealers would be required to furnish to customers approved for GNMA options trading disclosure material concerning the risks of trading in GNMA options.[24] The CBOE has also undertaken to develop an examination and education program for member firm personnel selling GNMA options to the public and persons supervising such activities, in an effort to ensure that such persons are sufficiently knowledgeable about GNMA options, the GNMA cash market, and the rules applicable to the sales and trading of GNMA options to deal appropriately with public customers.[25] The Commission believes that the requirements currently proposed,[26]

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[22] *Report of the Special Study of the Options Markets to the Securities and Exchange Commission*, H. R. Rep. IPC3, 96th Cong., 1st Sess. (Comm. Print 1978) ("Options Study").

[23] This account approval requirement would apply only to CBOE members. The Commission urges the other exchanges and the National Association of Securities Dealers, Inc. to adopt similar requirements applicable to their members trading in GNMA options on an access basis.

[24] The Options Clearing Corporation ("OCC") has not yet filed disclosure material relating to GNMA options with the Commission. The adequacy of such disclosure will be reviewed by the Commission before trading in GNMA options can begin.

[25] While the CBOE's education and examination program will not be applicable to persons associated with non-CBOE member firms doing business in GNMA options, such persons must have sufficient knowledge and information concerning GNMA options to permit them to evaluate their appropriateness for customers.

[26] The CBOE proposal also would apply position and exercise limits to GNMA options trading that are more stringent than those currently applicable to equity options. Some commentators expressed concern that

(footnote continued)

together with the modifications that CBOE has undertaken to make, should provide an adequately regulated environment for the trading of GNMA options.

C. *Margin requirements.*

The proposal would provide for the application of premium-based margin requirements to GNMA options transactions. Essentially, the proposed minimum margin requirement for each put or call GNMA options contract carried in an uncovered short position would be 130 percent of the current market value of the contract plus $1,500.[27] CBOE has indicated its belief that this level would provide adequate coverage in the event of adverse price movements and would be less complex to calculate than margin based on a percentage of the value of the underlying securities (as margin for equity options is currently calculated). Since Regulation T (12 CFR 5220.1 *et seq.*), which is administered by the FRB, establishes initial margin requirements for the trading of options, including GNMA options, the CBOE's proposed premium-based margin rules cannot become effective without action by the Board of Governors of the Federal Reserve System.[28] The Commission understands that the FRB is considering a CBOE request for amendments to Regulation T to permit the trading of GNMA options using a premium-based margin.

(footnote continued)
such limits might not be high enough to permit normal institutinal activity in the GNMA markets, but indicated that the limits chosen were acceptable as an initial matter. See, *e.g.*, FRB-NY letter; letter dated November 5, 1980, from Robert L. Shomaker, Vice Chairman, Mortgage Backed Securities Division, Public Securities Association, to George A. Fitzsimmons, Secretary to the Commission.

[27] The premium for put or call GNMA options contracts carried in a long position would be required to be fully paid.

[28] In commenting on the CBOE proposal, both the FRB staff and FRB-NY indicated the view that the current margin level for equity options appears inappropriate for GNMA options. See FRB letter, FRB-NY letter.

While Regulation T establishes initial margin requirements, the FRB has not adopted provisions with respect to maintenance margin. Accordingly, Commission approval of the CBOE proposal will establish maintenance margin requirements for the trading of GNMA options. The Commission believes that the level of maintenance margin proposed by CBOE is appropriate. Nevertheless, if the FRB determines not to approve the CBOE's current margin proposal, the Commission expects the CBOE to reexamine the appropriateness of its maintenance margin requirements in light of the FRB determination.

D. *Pricing considerations.*

Certain commentators also were concerned whether the price-related information concerning the markets for GNMA securities would be adequate for pricing GNMA options. In particular, the CBT argued that, since pricing in the existing options market is dependent upon information concerning transactions in the underlying securities, the creation of a GNMA options market would pose serious problems if adequate price-related information is not available. As the CBT recognizes, there is no real time transaction reporting system or regulated quotation reporting system for the GNMA cash market, as there is for the cash market in securities underlying equity options.[29] While the Commission recognizes that the absence of last sale reporting and of regulated quotation reporting will not permit GNMA options to be priced in the same manner as equity options are priced,[30] on balance the Commission believes that there is sufficient information available to permit the pricing of GNMA options. As the Amex letter points out, the data currently available with respect to prices in the GNMA cash market supports a substantial volume of trading in that market.[31] In part, such

[29] See also HUD letter.

[30] See generally Options Study, at 933.

[31] Amex letter.

trading can occur efficiently in the absence of more detailed transaction information because of the importance and availability of interest rate information in GNMA pricing. In addition to price information from the cash market, data which may be used for pricing purposes will be available from the futures market, as well as from the CBOE's GNMA options market. Accordingly, the Commission believes, at least as a preliminary matter, that there will be sufficient information available on the CBOE floor to permit the maintenance of a fair and orderly market in GNMA options.

E. *Surveillance.*

In connection with its proposal, the CBOE has furnished to the Commission general information concerning its plan for surveillance of GNMA options trading.[32] The CBOE's surveillance procedures for its GNMA options market necessarily differ in certain respects from its procedures with respect to its equity options market, primarily because of the different regulatory structures existing in the GNMA markets. The Commission anticipates that, as experience is gained with respect to the trading of GNMA options, CBOE will make any modifications in its surveillance system that appear necessary, since adequate surveillance is essential in order to realize the benefits and efficiencies expected from a regulated market and to ensure the integrity of the market.[33] In order to permit the Commission to evaluate the

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[32] The Commission also is requesting the CBOE to furnish a more complete description of its GNMA options surveillance program before it commences trading.

[33] On February 18, 1981, the CBOE filed with the Commission proposals to amend its rules, among other things, to permit it to obtain information concerning trading in the GNMA markets by affiliates of GNMA options market makers and to specify the types of information required from market makers. In addition, the CBOE filing would prescribe qualification requirements for GNMA options personnel. See File No. SR-CBOE-81-2. The CBOE has represented that the amendments will be considered by its Board of Directors in March.

operation of the surveillance program, the CBOE should report to the Commission concerning its GNMA options surveillance activities six months after trading in GNMA options begins on the CBOE and again in one year after that trading begins.

F. *Multiple trading.*

The Commission's consideration of the CBOE proposal to trade options on GNMA securities and the filing of a similar proposal by the New York Stock Exchange (the "NYSE")[34] have raised questions regarding multiple trading of these instruments and options on other non-equity securities. With respect to options on equities, the Commission has deferred action on the general expansion of multiple trading, among other reasons, in order to permit the options self-regulatory organizations to consider whether the development of technical facilities to integrate to options markets is feasible.[35] Several commentators have questioned whether the decision to defer this issue would also preclude multiple trading of options on non-equity securities.[36]

As a preliminary matter, the Commission does not believe that its decision to defer consideration of whether to permit expansion of multiple trading in equity options should apply to multiple trading of options on non-equity securities. Restricting multiple trading with respect to non-equity options would widen the Commission's role in allocating market "franchises." While the Commission has, pending a decision on mulitiple trading, permitted franchising of equity options, market allocation would be significantly more difficult here, given the limited number of optionable non-equity

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[34] On January 30, 1981, the NYSE filed a proposed rule change pursuant to Section 19(b) of the Act to trade options on GNMAs. See File No. SR-NYSE-81-4.

[35] See Securities Exchange Act Release No. 16701 (March 26, 1980).

[36] At least one commentator appears to have assumed that this deferral would be extended to options on non-equity securities. *See* Treasury letter.

instruments.[37] In addition, allocation of non-equity options, would also remove any potential for competition on the basis of variations in the contract design of options on the same underlying security,[38] a phenomenon that has occurred to some extent in the futures market. As indicated above, the Commission believes that it is desirable that market forces, as opposed to regulatory intervention, determine the optimal contract design and trading environment for options on non-equity securities.

The Commission's current deferral of a decision with respect to the expansion of multiple trading of equity options has in part arisen out of a concern that, given the historical development of the markets for those securities and the importance of options trading to the existing options marketplaces, unlimited expansion of multiple trading of equity options would result, as a practical matter, in only a transitory increase in market competition while at the same time precipitating significant changes in the existing structure of the options markets. While the Commission does not believe that it is appropriate to take regulatory measures designed solely to preserve any particular market or exchange, it remains concerned that unlimited multiple trading

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[37] For example, when the Commission deferred its decision on the expansion of multiple trading of equity options, the existing options exchanges initially were able to select sixty new underlying securities for options trading. In contrast, there appear to be only a limited number of non-equity securities that could be allocated for options trading.

[38] For example, the Amex indicated its belief that the proposed CBOE contract does not adequately address market needs. See discussion, *supra*. Moreover, if the Commission were to attempt to allocate options on non-equity securities, problems would arise concerning the method to be used in that allocation. For example, the Commission could allocate only one option for each underlying instrument or could attempt to make difficult decisions based on whether contracts on the same underlying instrument were sufficiently different to, in effect, constitute different instruments.

of equity options at this time might result in significant deleterious structural changes in the markets,[39] with a resultant decrease in competition in other areas such as services relating to execution and clearing functions. As a result, the Commission has expressed an unwillingness to permit further multiple trading absent further study of its ramifications.

Such considerations are not, however, raised in the context of a prospective market in options on non-equity securities. No potential market has committed significant resources on the basis of exclusive franchising, nor is there any functioning market structure that would be disrupted by the existence of multiple trading. Moreover, the Commission believes, at least as a preliminary matter, that allowing multiple trading in the limited area of non-equity options would not have the potential to jeopardize a marketplace's financial viability or its ability to participate in other areas of the securities markets. Accordingly, the Commission believes that multiple trading of non-equity options may be beneficial to the marketplace and preserve the potential for competition among market centers in this new product, without the possibility of the severe adverse effects that might occur as a result of unlimited multiple trading in the established equity options markets. As a result, the Commission is not inclined, at this time, to defer multiple trading of options on non-equity securities. Early consideration of this issue will provide guidance to those that want to submit other non-equity options proposals. The Commission, therefore, is soliciting comments on the multiple trading question in the context of its publication of the NYSE GNMA options filing.[40]

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[39] See, Securities Exchange Act Release No. 16701 (March 26, 1980) at n. 47.

[40] See Securities Exchange Act Release No. 17573 (February 26, 1981).

III. FINDINGS AND CONCLUSION

Under Section 19 (b) (2) of the Act, the Commission must approve the CBOE's proposed rule change if it finds that the proposed rule change is consistent with the requirements of the Act and the rules thereunder applicable to the CBOE. For the most part, the applicable statutory requirements are found in Section 6(b) of the Act, 15 U.S.C. 78f(b), which contains a number of requirements for the rules of national securities exchanges. The Commission has carefully reviewed the CBOE proposal and has concluded that it is appropriate for the CBOE to amend its rules to provide for the trading of options on GNMA securities.[41] It should be noted, however, that such trading cannot begin until the CBOE has satisfied other necessary requirements, such as conformance of its rules with the FRB margin requirements, and until the OCC has obtained approval of a disclosure document for GNMA options and has filed any necessary amendments to its rules. The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder and, in particular, the requirements of Section 6 and the rules and regulations thereunder.

IT IS THEREFORE ORDERED, pursuant to Section 19 (b) (2) of the Act, that the above-mentioned amended proposed rule change be, and it hereby is, approved.

By the Commission.

GEORGE A. FITZSIMMONS
Secretary

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[41] The Commission anticipates that the CBOE will provide data which will facilitate the Commission's ability to monitor the extent of trading and the quality of the market in CBOE GNMA options.

UNITED STATES OF AMERICA

before the

SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Release No. 18015/August 6, 1981
In the Matter of
The Options Clearing Corporation.

(File No. SR-OCC-81-2)

ORDER APPROVING PROPOSED RULE CHANGE

On February 20, 1981, OCC filed with the Commission, pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934, 15 U.S.C. 78s(b)(1) (the "Act") and Rule 19b-4 thereunder, a proposed rule change that would empower OCC to issue options on Government National Mortgage Association (GNMA) securities, to clear and settle GNMA options transactions, and to process and settle GNMA options exercises. OCC's filing is designed to facilitate the trading of options on GNMA securities on OCC participating exchanges.[1]

Notice of the proposed rule change together with its terms of substance was provided by publication of a Commission Release (Securities Exchange Act Release No. 17598, March 4, 1981) and by publication in the Federal Register (46 FR 16013, March 12, 1981). On May 8, 1981, OCC filed various

[1] On February 26, 1981, the Commission approved proposed rule changes filed by the Chicago Board Options Exchange, Incorporated ("CBOE") to enable the trading of GNMA options. *See* Securities Exchange Act Release No. 17577 (February 26, 1981) 46 FR 15242 (March 4, 1981).

technical clarifying amendments. Two letters of comment were received by the Commission.[2]

Description of the Proposed Rule Change

To the greatest extent feasible, OCC will use its exisiting procedures for processing equity options to process GNMA options. In certain areas, however, OCC's proposed procedures for processing GNMA options vary in important respects from its procedures for equity options. Because OCC's proposed system contains some major rule changes, and because OCC's proposed rule changes are extensive and detailed, the Commission believes it important to discuss in this approval order the more significant features of OCC's proposal. Before discussing those specific features, however, it seems useful to describe generally OCC's proposed GNMA options system.

Procedurally, under OCC's proposal, before clearing members may clear transactions in GNMA options, they will have

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[2] Letters dated March 25, 1981 from Robert K. Wilmouth, President, Chicago Board of Trade ("CBT"), to George A. Fitzsimmons, Secretary of the Commission, and March 31, 1981 from Mahlon M. Frankhauser, Kirkland and Ellis, to George A. Fitzsimmons, Secretary, Securities and Exchange Commission. In general, the commenters argued that (i) the Commission generally lacks jurisdiction to regulate the issuance and trading of all options; (ii) the Commission specifically lacks jurisdiction to regulate the issuance and trading of the proposed GNMA options; and (iii) the proposed GNMA options are within the jurisdiction of the Commodity Futures Trading Commission and, therefore, the current proscription of commodity options, pursuant to the Commodities Exchange Act (CEA), 7 U.S.C. 1 *et seq.*, and the rules and regulations thereunder, apply to the OCC proposal. The Commission disagrees with those contentions. The Commission has concluded that it has jurisdiction under the Federal securities laws to consider a proposed rule change of a registered clearing agency, acting pursuant to the Act, to issue options and clear and settle transactions with respect to options on GNMAs. Moreover, the Commission does not believe the CEA is applicable to the issuance, clearance and settlement of transactions with respect to options on GNMA securities, particularly when processed through the facilities of a registered clearing agency. *Cf.* Securities Exchange Act Release No. 17577, February 26, 1981, 46 FR 15242 (March 4, 1981).

to receive special authorization from OCC. To receive such authorization, at least two key operations employees from each clearing member firm will have to attend OCC readiness review sessions and successfully complete OCC's operational and financial examinations relating to GNMA options. OCC believes that such special training is necessary in view of the differences between the proposed system for GNMA options and the system used for stock options.

Operationally, under OCC's proposal, as in its stock options program, OCC will issue and process GNMA options each trading day. After it receives tapes of compared transactions from the CBOE and other participating exchanges, OCC will tabulate the appropriate long and short options positions in clearing members' accounts by creating automated book entries.[3] OCC will update those positions daily as dictated by members' trading activity, and it will provide procedures to effect money settlement among OCC members.

Also as in its stock options program, OCC will process exercise notices for GNMA options. On receipt of exercise instructions from clearing members, OCC will randomly assign an exercise notice to a clearing member that has a corresponding short position (*i.e.*, a clearing member that previously sold such an option). Unlike the stock options system, however, OCC will not forward information concerning exercises and assignments to various correspondent clearing corporations for netting and settlement of exercised and assigned positions. Rather, OCC itself will net those positions for each OCC member and oversee physical settlement of exercised and assigned GNMA options, in accordance with OCC's settlement rules.

Settlement for all GNMA option contracts exercised during the monthly settlement cycle will occur on the third Wednes-

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[3] As an issuer of GNMA options, OCC will register the GNMA options that it issues with the Commission pursuant to Section 12 of the Act. OCC further will disseminate a supplement discussing standardized GNMA options in addition to its detailed prospectus for standardized stock options.

day of each month. To facilitate settlement, OCC has proposed a "cut-off day"—the second Friday preceding the settlement date—by which clearing members must ordinarily exercise their GNMA options if those options are to settle during that month's cycle. During the weekend following the cut-off day OCC will net each clearing member's short and long obligations in each type of GNMA option having the same exercise price. The following Monday OCC will issue to clearing members net receive or deliver orders, which will instruct one clearing member to deliver, and another to receive, $100,000 worth of GNMAs per contract at the exercise price (subject to a permitted 2.5% variance). Upon receipt of those settlement instructions, the delivering clearing member will have one week (*i.e.*, until the Monday preceding the Wednesday settlement day) to determine which GNMAs it will deliver, and to notify the receiving clearing member. The parties then will agree on the precise exercise price as calculated in accordance with OCC's exercise price rules, with OCC resolving any disputes.

Settlement will occur in New York City once a month on exercise day. Under the proposal, a delivering clearing member could fail to make delivery without penalty until the third business day prior to the end of the month. OCC refers to this hiatus as the "grace period", which OCC provided so that members would have a reasonable degree of flexibility in settling exercised GNMA options. If the clearing members have not honored their settlement obligations by the end of the grace period, however, the receiving clearing member would be required to buy-in, or the delivering clearing member would be required to sell-out, its position. In that event, the party failing to discharge its obligations (and, in the event of the insolvency of an assigned party, OCC),[4] would be liable for any loss suffered as a result of the buy-in or sell-out.

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[4] As is true of OCC's stock option system, OCC guarantees the obligations of writers of options contracts. As a result, under its rules OCC remains liable to purchasing clearing members for defaults by assigned clearing members.

To help ensure that OCC members will satisfy the obligations that arise from their GNMA options positions, OCC will impose financial responsibility requirements substantially similar to those it imposes in its stock options program. First, OCC will impose its own net capital requirements on clearing members. Second, OCC will require clearing members with short positions to maintain margin with OCC with respect to the short positions.[5] That margin requirement will be adjusted daily by OCC, as necessary, and can be satisified by the deposit of cash or can be secured by government securities or bank letters of credit.[6] Finally, so that OCC and its members are protected even if the margin deposit proves insufficient to cover a loss, OCC will maintain a clearing fund for debt securities options.

Determinations Regarding OCC's Proposed GNMA Options Clearing Rules

Under Section 19(b)(2) of the Act, the Commission must approve OCC's proposed rule change if the Commission finds that it is consistent with the requirements of the Act and the rules thereunder applicable to registered clearing agencies. The principal provisions of the Act applicable to clearing agencies are contained in Section 17A. Paragraph (b) (3) of that Section requires that the rules of a clearing agency, among other things, be designed: (i) "to promote the prompt and accurate clearance and settlement of securities transac-

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[5] Proposed amendment to OCC Rule 601.

[6] In OCC's GNMA margin program, unlike its margin program for stock options, clearing members will not be permitted to deposit GNMA certificates underlying short call positions in lieu of margin. That is, OCC will not allow members to maintain "covered" call positions at OCC. In its filing OCC explained its decision to preclude the use of covered call positions at OCC by noting that the monthly pay-down of principal on deposited GNMAs could cause a certificate's principal balance to drop below $97,500, the minimum deliverable amount. In addition, a decline in the GNMA production rate (i.e., the rate of interest .50% below the stated rate of interest on residential mortgages issued by the Federal Housing Administration or guaranteed by the Veterans Administration) could render the deposited GNMAs undeliverable.

tions," (ii) "to assure the safeguarding of funds and securities which are in the custody or control of the clearing agency," (iii) "to foster cooperation and coordination with persons engaged in the clearance and settlement of securities transactions," and (iv) "to remove impediments to and perfect the mechanism of a national system for the prompt and accurate clearance and settlement of securities transactions, and, in general, to protect investors and the public interest."

OCC Margin Requirements for Debt Securities Option

Generally, the margin requirement on short positions at OCC will be equal to the current asked price of the options carried in short positions, plus a "cushion" of no more than $1,500 per contract, and will be adjusted daily based upon changes in each clearing member's aggregate short options positions. OCC anticipates that, by requiring the deposit of the price of the option plus a fixed-dollar cushion to cover the risk of market movement, the margin will be sufficient to close out short positions of any clearing member that fails to satisfy its obligations to OCC.

Under its GNMA option proposal, as with its current stock options program, OCC would continue to require daily margin for all short options positions, including GNMA options positions. It would use a different formula, however, to calculate the GNMA options margin requirement. With respect to short stock option positions, OCC currently requires participants to deposit 130 percent of the market price of an offsetting long contract. That margin deposit has proved effective in the past, by providing OCC with a 30 percent cushion to guard against adverse daily market movement. In contrast, OCC would require margin on short GNMA positions equal to the current market price of an offsetting long GNMA option[7] plus a "minimum margin

[7] For purposes of calculating margin on a clearing member's net short positions in GNMA options, however, OCC will require margin for assigned short positions based on their intrinsic (in-the-money) value, rather than on the basis of the market price of the option.

amount."[8] Thus, OCC's "protective cushion" for debt securities options would include a specific dollar amount, rather than a specified percentage of the market price of the option.[9]

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[8] The minimum margin for each short position will be set contract-by-contract at a point between $250 and $1500 (or whatever higher limit OCC selects as necessary, from time to time) depending on the degree to which the contract is out-of-the-money. In its filing, OCC indicated that it selected the initial $1500 ceiling for in-the-money contracts as a conservative precaution and would review the need for a different upper limit in light of experience.

OCC's selection of a $1500 ceiling was predicated on sample calculation runs performed by OCC during several periods of active trading in GNMA securities. The results of those runs revealed that, using a $1500 cushion for prospective standardized GNMA contracts, OCC would be fully protected against a one-day market movement on more than 95 percent of the days. In those instances in which the $1500 margin would be inadequate, OCC would invoke a same-day variation margin call pursuant to OCC's existing rules.

[9] In its filing, OCC indicated that it selected the minimum margin approach for debt securities options for two reasons. First, OCC contends that the degree of protection afforded OCC by tying the margin amounts to a percentage of the premium depends on the relationship between the premium levels and the price of the underlying security. When premium levels are relatively high, as OCC contends is true of stock options, the cushion tends to be sufficient. However, when premium levels are low, as OCC anticipates will be true of GNMA options, a modest fixed percentage of the premium may prove insufficient in some instances.

Second, OCC indicated that, as a general matter, a "fixed cushion" margin approach is preferable whenever feasible, since the percentage-of-market-value approach can produce excessive margin for deep-in-the-money positions. According to OCC, the "fixed cushion" margin approach has not been feasible for stock options, however, because the varying volatility of stock options on different underlying securities would result in different minimum amounts for different classes of options, which would make margin calculations prohibitively complex to administer. In contrast, OCC continues, debt securities options tend to display fairly uniform volatility characteristics because prices tend to be controlled by a single factor—interest rates. Moreover, because there is only one class of GNMA options, all GNMA options will have the same volatility characteristic. Accordingly, OCC concludes, and the Commission has no reason to disagree, that a minimum margin approach seems both desirable and feasible for GNMA options.

Also, OCC's proposal provides OCC with authority to prescribe greater amounts of margin as circumstances require. Toward that end, OCC plans to review its margin levels periodically in light of its experience and will use its authority to adjust margin levels as necessary.

Finally, OCC proposes to amend existing OCC Rule 602 concerning margin on exercised contracts to enable OCC to apply its current rules respecting exercised stock options positions to exercised debt securities options positions. Currently, Rule 602 provides that OCC may impose margin on exercised positions that are out-of-the-money, *i.e.*, positions that carry an exercise price that (i) exceeds (in the case of calls) or (ii) is less than (in the case of puts) the market price of the underlying security. While OCC has not imposed this margin in the past for stock options,[10] it anticipates that it will do so with respect to GNMA options. Since exercised GNMA positions may not settle for as much as six weeks under OCC's rules and industry practice, some exercised GNMA positions may fall out-of-the-money during the clearing cycle. In that event, OCC will impose margin under its proposed rules equal to 100 percent of the difference between the market value of the underlying GNMA and the aggregate exercise price, plus a minimum margin of $1,500 for each contract carried in a net long exercise position.

The Commission believes that OCC's proposed minimum margin approach, as well as the selected minimum levels, are appropriate to protect the interest of OCC and its members and accordingly finds those rules consistent with the requirements of the Act. Those rules are either similar to the margin rules OCC uses effectively for equity options or they incorporate features reasonably designed to accommodate special characteristics of GNMA options.

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[10] OCC has not used this margin in the past because out-of-the-money positions rarely get exercised, and few in-the-money positions fall out-of-the-money during the brief five-day lag between exercise and settlement of stock options.

Separate Debt Securities Clearing Fund

In addition to maintaining a clearing fund[11] for options on stock (the "Stock Clearing Fund"), OCC proposes to amend Article VIII of its By-Laws to establish a separate clearing fund for operations on debt securities (the "Debt Securities Clearing Fund"). That separate clearing fund would help to protect OCC against losses sustained in connection with GNMA or government securities options. Several aspects of both funds will be nearly identical, including the purposes for the funds, the formula for determining the required contributions, and the method for charging losses to the fund.

In its filing, OCC explained that it decided to propose a separate Debt Securities Clearing Fund because some clearing members that clear transactions in stock options may not elect to clear transactions in debt securities options. Accordingly, OCC would separate, though not completely, the stock clearing fund and the debt securities clearing fund. To help preserve the ultimate solvency of OCC, however, OCC's proposal provides that the Stock Clearing Fund would serve as a "last-resort back-up" to the Debt Securities Clearing Fund in the event the latter fund was insufficient to cover a loss.[12]

The Commission believes that OCC's proposed clearing fund arrangements are appropriate in the interest of OCC and its members. In this instance, the rules respecting each fund appear to be reasonably designed to achieve their objectives, and an added dimension of safety exists because each separate clearing fund will back-up the other. Finally, at least for the present, OCC's proposed clearing fund formula appears to be reasonably related to the likely levels

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[11] A "clearing fund" is a fund maintained by a clearing agency to which clearing members contribute collateral to safeguard the clearing agency against certain losses resulting from a member's default.

[12] Conversely, the Debt Securities Clearing Fund would serve as "last-resort back-up" to the Stock Clearing Fund.

of exposure. It is based on OCC's extensive experience with suitable requirements for the stock options clearing fund, and, absent further experience with GNMA options activity, should be a suitable initial requirement.

Procedures for Settlement of GNMA Options Exercises

OCC's system for the settlement of exercises in GNMA options differs significantly from its settlement system for equity options. As noted, settlement of exercises in equity options is effected through correspondent clearing corporations. Those clearing corporations process options exercises along with other transactions in the underlying securities. Currently, however, the bulk of GNMA processing is handled on a broker-to-broker basis. Therefore, under OCC's proposed GNMA settlement rules and procedures, settlement will be conducted directly by clearing members, without OCC's intervention, substantially in accordance with current practices in the existing GNMA markets.

Functionally, OCC has adopted a type of balance order settlement system.[13] On a monthly basis OCC will net each clearing member's long and short obligations in each type of GNMA option having the same exercise price. After deriving net positions OCC will conduct an "allocation" process in which those clearing members whose settlement obligations did not net out fully are paired with reciprocal obligations of other members. Those clearing members then will settle with each other through the physical exchange of GNMAs and money. To minimize the number of separate settlements that clearing members must make, OCC will attempt to match clearing members that are obligated to make deliveries of block size with clearing members that have the right to receive block-size deliveries. In addition, OCC's requirement that all options exercises be settled in New York City,

[13] OCC's proposed balance order system is substantially similar to balance order systems currently operated by other registered clearing agencies.

unless the parties agree otherwise, reflects the current practice in cash market transactions and should facilitate turn-around deliveries.

OCC's proposed system for settling exercises in GNMA options appears reasonably well designed to operate efficiently and accurately. Moreover, the Commission recognizes that OCC's rules for physical settlement are based on industry custom and historically have worked well. Consistent with that tradition, OCC's proposed role in the settlement process provides broker-dealers with significant flexibility in completing GNMA options transactions. Nonetheless, in view of the experimental nature of OCC's role, the Commission directs OCC to inform it of any problems in settlement processing that develop and any responses OCC makes to those problems.

Procedures for Resolving Fails

As noted previously, in the event that clearing members fail to meet their settlement obligations, OCC's proposed rules provide for "buy-ins" and "sell-outs" similar to the close-out procedures used with respect to equity options. More specifically, if a delivering clearing member fails to deliver the underlying GNMAs by the end of the grace period, the clearing member due to receive GNMAs must buy the GNMAs in the cash market, holding the defaulting party liable for any loss on the buy-in transaction. Similarly, if the receiving clearing member refuses to accept the tender of the underlying GNMAs, the delivering clearing member must sell those securities in the cash market, with the defaulting party again responsible for any loss.[14] These provisions are intended to discourage fails, to provide remedies for nonfailing clearing members, and to impose a fixed deadline by which settlement must be made, either in the normal fashion or through buy-ins or sell-outs.

[14] In keeping with OCC's flexibly designed settlement procedures, OCC can direct that a buy-in or sell-out be deferred if OCC has reason to believe that the default will be cured before the last business day of the month.

OCC's proposal generally does not provide rules or procedures for resolving disputes between clearing members that arise during the settlement cycle. Similarly, OCC has not provided a mechanism for determining whether, in particular cases, a clearing member has failed to discharge its settlement obligations, thereby justifying a buy-in or sell-out. However, OCC indicated in its filing that such disputes may be resolved through means already available, such as negotiation, arbitration or litigation. Moreover, OCC notes, disputes in existing GNMA markets commonly are resolved by broker-dealers through informal negotiation. Thus, because OCC believes that most, if not all, disputes will be settled through informal negotiation, OCC believes it is unnecessary at this time to develop a complex dispute-resolution system at OCC. Nonetheless, the Commission expects that if problems arise in the settlement of options, OCC will develop, or help another entity develop, an effective system to resolve such disputes. In any event, at the present time OCC's proposed rules respecting exercise and settlement appear reasonably designed to promote safety, promptness, and accuracy in the clearance and settlement of GNMA options transactions.

Conclusion

In accordance with the foregoing, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to registered clearing agencies, and, in particular, the requirements of Section 17A of the Act and the rules and regulations thereunder.

It is therefore ordered, pursuant to Section 19 (b) (2) of the Act, that the proposed rule change be, and it hereby is, approved.

Opinion by Judge Cummings
Judge Cudahy dissenting
JUDGMENT—ORAL ARGUMENT
In the

United States Court of Appeals

For the Seventh Circuit

Chicago, Illinois 60604
March 24, 1982

Before

Hon. WALTER J. CUMMINGS, *Chief Judge*

Hon. RICHARD D. CUDAHY, *Circuit Judge*

Hon. WILLIAM J. CAMPBELL, *Senior District Judge**

No. 81-1660
BOARD OF TRADE OF THE CITY OF CHICAGO,
Petitioner,

v.

SECURITIES AND EXCHANGE COMMISSION,
Respondent,

and

CHICAGO BOARD OPTIONS EXCHANGE, INC.,
Intervenor-Respondent.

On Petition for Review of an Order of the
Securities and Exchange Commission.

This cause came on to be heard on the record from the Securities and Exchange Commission, and was argued by counsel.

On consideration whereof, IT IS ORDERED AND ADJUDGED by this Court that the SEC order of February 28, 1982 is set aside and our prior stay is dissolved, with costs to be taxed to respondents, in accordance with the opinion of this Court filed this date.

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* The Honorable William J. Campbell, Senior District Judge for the Northern District of Illinois, is sitting by designation.

Unpublished Per Curiam Order
Judge Cudahy dissenting

JUDGMENT—WITHOUT ORAL ARGUMENT
In the

United States Court of Appeals

For the Seventh Circuit
Chicago, Illinois 60604
March 24, 1982

Before

Hon. WALTER J. CUMMINGS, *Chief Judge*

Hon. RICHARD D. CUDAHY, *Circuit Judge*

Hon. WILLIAM J. CAMPBELL, *Senior District Judge**

No. 81-2587
BOARD OF TRADE OF THE CITY OF CHICAGO,
Petitioner,

v.

SECURITIES AND EXCHANGE COMMISSION,
Respondent,

THE OPTIONS CLEARING CORPORATION,
Intervenor-Respondent,

CHICAGO BOARD OPTIONS EXCHANGE, INC.,
Intervenor-Respondent.

On Petition for Review of an Order of the
Securities and Exchange Commission.

This cause came on to be heard on the record from the Securities and Exchange Commission.

On consideration whereof, IT IS ORDERED AND ADJUDGED by this Court that the SEC order of August 6, 1981 is set aside, with costs to be taxed to respondents, in accordance with the order of this Court entered this date.

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* The Honorable William J. Campbell, Senior District Judge for the Northern District of Illinois, is sitting by designation.

In the

United States Court of Appeals

For the Seventh Circuit

Chicago, Illinois 60604

May 27, 1982

Before

Hon. WALTER J. CUMMINGS, *Chief Judge*

Hon. RICHARD D. CUDAHY, *Circuit Judge*

Hon. WILLIAM J. CAMPBELL, *Senior District Judge**

No. 81-1660
81-2587

BOARD OF TRADE OF THE CITY OF CHICAGO,
Petitioner,

v.

SECURITIES AND EXCHANGE COMMISSION,
Respondent,

and

CHICAGO BOARD OPTIONS EXCHANGE, INCORPORATED,

THE OPTIONS CLEARING CORPORATION,
Intervenors-Respondents.

On Petition for Review of an Order of the
Securities and Exchange Commission.

ORDER

On consideration of the Petitions for Rehearing and related documents, the Petitions are denied. No judge in active service having requested a rehearing *en banc*, a rehearing *en banc* is also denied.

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* The Honorable William J. Campbell, Senior District Judge of the United States District Court for the Northern District of Illinois, is sitting by designation.

STATUTES AND REGULATION INVOLVED

Commodity Exchange Act, as amended (the "CEA"), 7 U.S.C. §§1-24(1976)

Section 2(a)(1) of the CEA, 7 U.S.C. §2 (1976)

For the purposes of this Act, "contract of sale" shall be held to include sales, agreements of sale, and agreements to sell. The word "person" shall be construed to import the plural or singular, and shall include individuals, asscciations, partnerships, corporations, and trusts. The word "commodity" shall mean wheat, cotton, rice, corn, oats, barley, rye, flaxseed, grain sorghums, mill feeds, butter, eggs, Solanum tuberosum (Irish potatoes), wool, wool tops, fats and oils (including lard, tallow, cottonseed oil, peanut oil, soybean oil and all other fats and oils), cottonseed meal, cottonseed, peanuts, soybeans, soybean meal, livestock, livestock products, and frozen concentrated orange juice, and all other goods and articles, except onions as provided in Public Law 85-839, and all services, rights, and interests in which contracts for future delivery are presently or in the future dealt in: Provided, That the Commission shall have exclusive jurisdiction with respect to accounts, agreements (including any transaction which is of the character of, or is commonly known to the trade as, an "option", "privilege", "indemnity", "bid", "offer", "put", "call", "advance guaranty", or "decline guaranty"), and transactions involving contracts of sale of a commodity for future delivery, traded or executed on a contract market designated pursuant to section 5 of this Act or any other board of trade, exchange, or market, and transactions subject to regulation by the Commission pursuant to section 19 of this Act: And provided further, That, except as herein above provided, nothing contained in this section shall (i) supersede or limit the jurisdiction at any time conferred on the Securities and Exchange Commission or other regulatory authorities under the laws of the United States or of any State, or (ii) restrict the Securities and

Exchange Commission and such other authorities from carrying out their duties and responsibilities in accordance with such laws. Nothing in this section shall supersede or limit the jurisdiction conferred on courts of the United States or any State. Nothing in this Act shall be deemed to govern or in any way be applicable to transactions in foreign currency, security warrants, security rights, resales or installment loan contracts, repurchase options, government securities, or mortgages and mortgage purchase commitments, unless such transactions involve the sale thereof for future delivery conducted on a board of trade. The term "future delivery" as used herein, shall not include any sale of any cash commodity for deferred shipment or delivery. The words "board of trade" shall be held to include and mean any exchange or association, whether incorporated or unincorporated, of persons who shall be engaged in the business of buying or selling any commodity or receiving the same for sale on consignment . . . .

* * *

Section 4c of the CEA, 7 U.S.C. 86c(1976 and Supp. II 1978)

(a) It shall be unlawful for any person to offer to enter into, enter into or confirm the execution of, any transaction involving any commodity, which is or may be used for (1) hedging any transaction in interstate commerce in such commodity or the products or byproducts thereof, or (2) determining the price basis of any such transaction in interstate commerce in such commodity, or (3) delivering any such commodity sold, shipped, or received in interstate commerce for the fulfillment thereof—

(A) if such transaction is, is of the character of, or is commonly known to the trade as, a "wash sale", "cross trade", or "accommodation trade", or is a fictitious sale;

(B) if such transaction involves any commodity specifically set forth in section 2(a) of this Act, prior to the enactment of the Commodity Futures Trading Commission

Act of 1974, and if such transaction is of the character of, or is commonly known to the trade as, an "option", "privilege", "indemnity", "bid", "offer", "put", "call", "advance guaranty", or "decline guaranty", or

(C) if such transaction is used to cause any price to be reported, registered, or recorded which is not a true and bona fide price.

Nothing in this section shall be construed to prevent the exchange of futures in connection with cash commodity transactions or of futures for cash commodities, or of transfer trades or office trades if made in accordance with board of trade rules applying to such transactions and such rules shall have been approved by the Commission.

(b) No person shall offer to enter into, enter into or confirm the execution of, any transaction subject to the provisions of subsection (a) of this section involving any commodity regulated under this Act, but not specifically set forth in section 2(a) of this Act, prior to the enactment of the Commodity Futures Trading Commission Act of 1974, which is of the character of, or is commonly known to the trade as, an "option", "privilege", "indemnity", "bid", "offer", "put", "call", "advance guaranty", or "decline guaranty", contrary to any rule, regulation or order of the Commission prohibiting any such transaction or allowing any such transaction under such terms and conditions as the Commission shall prescribe within one year after the effective date of the Commodity Futures Trading Commission Act of 1974 unless the Commission determines and notifies the Senate Committee on Agriculture, Nutrition, and Forestry and the House Committee on Agriculture that it is unable to prescribe such terms and conditions within such period of time: Provided, That any such order, rule, or regulation may be made only after notice and opportunity for hearing: And provided further, That the Commission may set different terms and conditions for different markets.

(c) Notwithstanding the provisions of subsection (b) of this section, no person may, after the enactment of the Futures Trading Act of 1978, offer to enter into, enter into, or confirm the execution of any commodity option transaction involving any commodity regulated under this Act but not specifically set forth in section 2(a) of this Act prior to the enactment of the Commodity Futures Trading Commission Act of 1974, until (1) the Commission transmits to the House Committee on Agriculture and the Senate Committee on Agriculture, Nutrition, and Forestry documentation of its ability to regulate successfully such transactions, including a copy of the Commission's proposed rules and regulations, and (2) the expiration of thirty calendar days of continuous session of Congress after the date of such transmittal. The Commission is not precluded from transmitting, at any time, documentation relating to its ability to regulate such transactions regarding individual commodities, classes of commodities, or regulation of such transactions on specific boards of trade. Nothing in this subsection shall affect any rights or obligations arising out of any transactions subject to the provisions of this subsection entered into, or the execution of which was confirmed, prior to October 1, 1978: Provided, That this prohibition shall not apply to any transaction expressly permitted under rules or regulations prescribed by the Commission, before or after the date of enactment of the Futures Trading Act of 1978, to be offered to be entered into, entered into, or confirmed, in which the purchaser is a producer, processor, commercial user of, or a merchant handling, the commodity involved in the transaction, or the products or byproducts thereof.

* * *

Securities Exchange Act of 1934, as amended (the "Exchange Act"), 15 U.S.C. §§78a-78kk (1976)

Section 3(a) of the Exchange Act, 15 U.S.C. §78c(a)(1976)

(a) When used in this chapter, unless the context otherwise requires—

* * *

(10) The term "security" means any note, stock, treasury stock, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit, for a security, or in general, any instrument commonly known as a "security"; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.

* * *

(12) The term "exempted security" or "exempted securities" includes securities which are direct obligations of, or obligations guaranteed as to principal or interest by, the United States; such securities issued or guaranteed by corporations in which the United States has a direct or indirect interest as shall be designated for exemption by the Secretary of the Treasury as necessary or appropriate in the public interest or for the protection of investors; municipal securities, as defined in paragraph (29) of this subsection: Provided, however, That municipal securities shall not be deemed to be "exempted securities" for purposes of sections 78o, 78o-3 (except subsections (b)(6), (b)(11), and (g)(2) thereof), and 78q-1 of this title; any interest or participation in any common trust fund or similar fund maintained by a bank exclusively for the collective investment and reinvestment of assets contributed thereto by such bank in its capacity as trustee, executor, administrator, or guardian; any interest or participation in a single trust fund, or a collective trust fund maintained by a bank, or any security arising out

of a contract issued by an insurance company, which interest, participation, or security is issued in connection with (A) a stock bonus, pension, or profit-sharing plan which meets the requirements for qualification under section 401 of Title 26, (B) an annuity plan which meets the requirements for the deduction of the employer's contribution under section 404(a)(2) of Title 26, or (C) a governmental plan as defined in section 414(d) of Title 26 which has been established by an employer for the exclusive benefit of its employees or their beneficiaries for the purpose of distributing to such employees or their beneficiaries the corpus and income of the funds accumulated under such plan, if under such plan it is impossible, prior to the satisfaction of all liabilities with respect to such employees and their beneficiaries, for any part of the corpus or income to be used for, or diverted to, purposes other than the exclusive benefit of such employees or their beneficiaries, other than any plan described in clause (A), (B), or (C) of this paragraph (i) which covers employees some or all of whom are employees within the meaning of section 401(c) of Title 26, or (ii) which is a plan funded by an annuity contract described in section 403(b) of Title 26; and such other securities (which may include, among others, unregistered securities, the market in which is predominantly intrastate) as the Commission may, by such rules and regulations as it deems consistent with the public interest and the protection of investors, either unconditionally or upon specified terms and conditions or for stated periods, exempt from the operation of any one or more provisions of this chapter which by their terms do not apply to an "exempted security" or to "exempted securities."

(13) The terms "buy" and "purchase" each include any contract to buy, purchase, or otherwise acquire.

(14) The terms "sale" and "sell" each include any contract to sell or otherwise dispose of.

* * *

Section 5 of the Exchange Act, 15 U.S.C. 878e(1976)

It shall be unlawful for any broker, dealer, or exchange, directly or indirectly, to make use of the mails or any means or instrumentality of interstate commerce for the purpose of using any facility of an exchange within or subject to the jurisdiction of the United States to effect any transaction in a security, or to report any such transaction, unless such exchange (1) is registered as a national securities exchange under section 78f of this title, or (2) is exempted from such registration upon application by the exchange because, in the opinion of the Commission, by reason of the limited volume of transactions effected on such exchange, it is not practicable and not necessary or appropriate in the public interest or for the protection of investors to require such registration.

Section 6(b) of the Exchange Act, 15 U.S.C. 878f(b)(1976)

(b) An exchange shall not be registered as a national securities exchange unless the Commission determines that—

(1) Such exchange is so organized and has the capacity to be able to carry out the purposes of this chapter and to comply, and (subject to any rule or order of the Commission pursuant to section 78q(d) or 78s(g)(2) of this title) to enforce compliance by its members and persons associated with its members, with the provisions of this chapter, the rules and regulations thereunder, and the rules of the exchange.

* * *

(5) The rules of the exchange are designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open

market and a national market system, and, in general, to protect investors and the public interest; and are not designed to permit unfair discrimination between customers, issuers, brokers, or dealers, or to regulate by virtue of any authority conferred by this chapter matters not related to the purposes of this chapter or the administration of the exchange.

* * *

Section 9 of the Exchange Act, 15 U.S.C. §78i(1976)

* * *

(b) It shall be unlawful for any person to effect, by use of any facility of a national securities exchange, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors—

(1) any transaction in connection with any security whereby any party to such transaction acquires any put, call, straddle, or other option or privilege of buying the security from or selling the security to another without being bound to do so; or

(2) any transaction in connection with any security with relation to which he has, directly or indirectly, any interest in any such put, call, straddle, option, or privilege; or

(3) any transaction in any security for the account of any person who he has reason to believe has, and who actually has, directly or indirectly, any interest in any such put, call, straddle, option, or privilege with relation to such security.

(c) It shall be unlawful for any member of a national securities exchange directly or indirectly to endorse or guarantee the performance of any put, call, straddle, option, or privilege in relation to any security registered on a national securities exchange, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

(d) The terms "put", "call", "straddle", "option" or "privilege" as used in this section shall not include any registered warrant, right, or convertible security.

* * *

(f) The provisions of this section shall not apply to an exempted security.

Section 17A(b) of the Exchange Act, 15 U.S.C. 878q-1(b)(1976)

(1) Except as otherwise provided in this section, it shall be unlawful for any clearing agency, unless registered in accordance with this subsection, directly or indirectly, to make use of the mails or any means or instrumentality of interstate commerce to perform the functions of a clearing agency with respect to any security (other than an exempted security). The Commission, by rule or order, upon its own motion or upon application, may conditionally or unconditionally exempt any clearing agency or security or any class of clearing agencies or securities from any provisions of this section or the rules or regulations thereunder, if the Commission finds that such exemption is consistent with the public interest, the protection of investors, and the purposes of this section, including the prompt and accurate clearance and settlement of securities transactions and the safeguarding of securities and funds. A clearing agency or transfer agent shall not perform the functions of both a clearing agency and a transfer agent unless such clearing agency or transfer agent is registered in accordance with this subsection and subsection (c) of this section.

* * *

(3) A clearing agency shall not be registered unless the Commission determines that—

(A) Such clearing agency is so organized and has the capacity to be able to facilitate the prompt and accurate clearance and settlement of securities transactions for which it is responsible, to safeguard securities and funds in its custody or control or for which it is responsible, to comply with the provisions of this chapter and the rules and regulations thereunder, to enforce (subject to any rule or order of the Commission pursuant to section 78q(d) or 78s(g)(2) of this title) compliance by its participants with the rules of the clearing agency, and to carry out the purposes of this section.

* * *

(F) The rules of the clearing agency are designed to promote the prompt and accurate clearance and settlement of securities transactions, to assure the safeguarding of securities and funds which are in the custody or control of the clearing agency or for which it is responsible, to foster cooperation and coordination with persons engaged in the clearance and settlement of securities transactions, to remove impediments to and perfect the mechanism of a national system for the prompt and accurate clearance and settlement of securities transactions, and, in general, to protect investors and the public interest; and are not designed to permit unfair discrimination in the admission of participants or among participants in the use of the clearing agency, or to regulate by virtue of any authority conferred by this chapter matters not related to the purposes of this section or the administration of the clearing agency.

* * *

Section 19 of the Exchange Act, 15 U.S.C. §78s(1976)

* * *

(b) (1) Each self-regulatory organization shall file with the Commission, in accordance with such rules as the Commis-

sion may prescribe, copies of any proposed rule or any proposed change in, addition to, or deletion from the rules of such self-regulatory organization (hereinafter in this subsection collectively referred to as a "proposed rule change") accompanied by a concise general statement of the basis and purpose of such proposed rule change. The Commission shall, upon the filing of any proposed rule change, publish notice thereof together with the terms of substance of the proposed rule change or a description of the subjects and issues involved. The Commission shall give interested persons an opportunity to submit written data, views, and arguments concerning such proposed rule change. No proposed rule change shall take effect unless approved by the Commission or otherwise permitted in accordance with the provisions of this subsection.

(2) Within thirty-five days of the date of publication of notice of the filing of a proposed rule change in accordance with paragraph (1) of this subsection, or within such longer period as the Commission may designate up to ninety days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or as to which the self-regulatory organization consents, the Commission shall—

(A) by order approve such proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved. Such proceedings shall include notice of the grounds for disapproval under consideration and opportunity for hearing and be concluded within one hundred eighty days of the date of publication of notice of the filing of the proposed rule change. At the conclusion of such proceedings the Commission, by order, shall approve or disapprove such proposed rule change. The Commission may extend the time for conclusion of such proceedings for up to sixty days if it finds good cause for such extension and publishes its reasons for so finding or for such longer period as to which the self-regulatory organization consents.

The Commission shall approve a proposed rule change of a self-regulatory organization if it finds that such proposed rule change is consistent with the requirements of this chapter and the rules and regulations thereunder applicable to such organization. The Commission shall disapprove a proposed rule change of a self-regulatory organization if it does not make such finding. The Commission shall not approve any proposed rule change prior to the thirtieth day after the date of publication of notice of the filing thereof, unless the Commission finds good cause for so doing and publishes its reasons for so finding.

* * *

Section 25(a) of the Exchange Act, 15 U.S.C. §78y(a) (1976)

(a) (1) A person aggrieved by a final order of the Commission entered pursuant to this chapter may obtain review of the order in the United States Court of Appeals for the circuit in which he resides or has his principal place of business, or for the District of Columbia Circuit, by filing in such court, within sixty days after the entry of the order, a written petition requesting that the order be modified or set aside in whole or in part.

(2) A copy of the petition shall be transmitted forthwith by the clerk of the court to a member of the Commission or an officer designated by the Commission for that purpose. Thereupon the Commission shall file in the court the record on which the order complained of is entered, as provided in section 2112 of Title 28 and the Federal Rules of Appellate Procedure.

(3) On the filing of the petition, the court has jurisdiction, which becomes exclusive on the filing of the record, to affirm or modify and enforce or to set aside the order in whole or in part.

(4) The findings of the Commission as to the facts, if supported by substantial evidence, are conclusive.

(5) If either party applies to the court for leave to adduce additional evidence and shows to the satisfaction of the court that the additional evidence is material and that there was reasonable ground for failure to adduce it before the Commission, the court may remand the case to the Commission for further proceedings, in whatever manner and on whatever conditions the court considers appropriate. If the case is remanded to the Commission, it shall file in the court a supplemental record containing any new evidence, any further or modified findings, and any new order.

Securities Investor Protection Act of 1970, as amended ("SIPA"), 15 U.S.C. §§78aaa-78*lll*

Section 16 of SIPA, 15 U.S.C. §78*lll*

For purposes of this chapter, including the application of the Bankruptcy Act to a liquidation proceeding:

* * *

(14) Security.—The term "security" means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, any collateral trust certificate, preorganization certificate or subscription, transferable share, voting trust certificate, certificate of deposit, certificate of deposit for security, any investment contract or certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or mineral royalty or lease (if such investment contract or interest is the subject of a registration statement with the Commission pursuant to the provisions of the Securities Act of 1933), any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase or sell any of the foregoing, and any other instrument commonly known as a security. The term "security" does not include any currency, or any commodity or related contract or futures contract, or any warrant or right to subscribe to or purchase or sell any of the foregoing.

Rules and Regulations Under the Securities Exchange Act of 1934

Rule 3a11-1, 17 C.F.R. §240.3a11-1 (1981)

The term "equity security" is hereby defined to include any stock or similar security, certificate of interest or participation in any profit sharing agreement, preorganization certificate or subscription, transferable share, voting trust certificate or certificate of deposit for an equity security, limited partnership interest, interest in a joint venture, or certificate of interest in a business trust; or any security convertible, with or without consideration into such a security, or carrying any warrant or right to subscribe to or purchase such a security; or any such warrant or right; or any put, call, straddle, or other option or privilege of buying such a security from or selling such a security to another without being bound to do so.

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Nos. 82-327, 82-526

IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

CHICAGO BOARD OPTIONS EXCHANGE INCORPORATED, *et al.*,
Petitioners,

v.

BOARD OF TRADE OF THE CITY OF CHICAGO,
Respondent.

BRIEF IN OPPOSITION TO THE PETITIONS FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT (SEVENTH CIRCUIT NOS. 81-1660, 81-2587)

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QUESTION PRESENTED

Whether the correct judgment of the court of appeals must be vacated solely because the case became moot as a practical matter as a result of legislative and regulatory actions prior to final briefing on the petitions for writs of certiorari.

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IN THE

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Petitioners,

v.

BOARD OF TRADE OF THE CITY OF CHICAGO,
Respondent.

BRIEF IN OPPOSITION TO THE PETITIONS FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

STATEMENT OF THE CASE

On September 11, 1975, the Board of Trade of the City of Chicago ("Board of Trade")[1] was designated by the Commodity Futures Trading Commission ("CFTC") as a contract market for futures contracts on Government National Mortgage Association mortgage-backed pass-through certificates ("GNMA's"). On April 17, 1980, the Chicago Board Options Exchange, Inc.

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[1] Pursuant to Rule 28.1 of the Rules of this Court, the Board of Trade states that it has no parent company, subsidiaries (other than wholly-owned subsidiaries), or affiliates.

("CBOE"), a registered national securities exchange, filed proposed rule changes with the Securities and Exchange Commission ("SEC") to accommodate the creation of a market in exchange-formed off-set options on GNMA's. The Options Clearing Corporation, Inc. ("OCC") filed rule changes on February 20, 1981, to provide for the issuance and clearance of the proposed options. The SEC approved the proposed rule changes of CBOE and OCC on February 26, 1981, and August 6, 1981, respectively. The Board of Trade, which had commented on both proposed rule changes, filed petitions for review of the SEC orders approving the CBOE and OCC rule changes in the United States Court of Appeals for the Seventh Circuit on April 24, 1981 (7th Cir. No. 81-1660), and October 5, 1981 (7th Cir. No. 81-2587), respectively.[2] In each petition, the Board of Trade contended that the SEC orders had to be set aside because the CFTC had exclusive jurisdiction over GNMA options trading and the SEC had no substantive authority under its statutes to authorize such trading.

The court below rendered judgment in both cases on March 24, 1982, with the majority finding for the Board of Trade and setting aside the SEC orders. At the beginning of its opinion in No. 81-1660, the court recognized that GNMA's are both securities under section 3(a)(10) of the Securities and Exchange Act of 1934 ("SEA"), 15 U.S.C. § 78c(a)(10), and commodities under section 2(a)(1) of the Commodity Exchange Act ("CEA"), 7 U.S.C. § 2 (1976)—a contention not disputed by any of the parties.

The court then focused on the terms of and congressional intent behind the CEA. It determined that the

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[2] The Board of Trade brought a third petition on January 21, 1982, challenging the SEC's approval of options trading on Treasury bonds, bills, and notes at CBOE and the American Stock Exchange (7th Cir. No. 82-1097). The Board of Trade has filed a motion to dismiss the petition.

express terms of section 4c(b)[3] and 4c(c),[4] 7 U.S.C. § 6c(b), (c) (1976 & Supp. II 1978), banned any trading of off-set commodity options, including GNMA options, unless traded pursuant to rules promulgated by the CFTC. The court went on to hold, however, that due to the so-called "SEC savings clause," the ban on options trading would not affect the SEC unless GNMA options fell within the CFTC's exclusive jurisdiction. Following a careful analysis of the statutory language and legislative history, the appeals court concluded that GNMA options were within the CFTC's exclusive jurisdiction. Therefore, any SEC jurisdiction was precluded, and the SEC's order also was expressly prohibited by the options ban sections of the CEA. As a final matter respecting the CFTC's power over GNMA options, the court of appeals held that the "Treasury amendment" did not divest the CFTC of exclusive jurisdiction over options on GNMA's.

As an alternate holding, the court found that apart from the prohibitions in the CEA the SEC had no authority under the securities laws as they stood at the time of its decision to authorize and regulate options on exempted securities such as GNMA's. The court held that exchange-formed off-set options were not securities under the terms of section 3(a)(10) of the SEA, 15 U.S.C. § 78c(a)(10). While SEA § 9(b), 15 U.S.C. § 78i(b), grants the SEC authority to regulate options, section 9(f), 15 U.S.C. § 78i(f), specifically withdrew

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[3] Section 4c(b) authorises options trading "involving any commodity regulated under this chapter" except certain specified agricultural commodities ("old" commodities), subject to CFTC promulgation of regulations.

[4] Section 4c(c), also known as the "options ban," dictates that "no person" may enter into "any commodity option transaction involving" any of the "new" commodities—including GNMA's—until the CFTC submits appropriate rule proposals to the Congress thirty days prior to their effective date.

that authority with respect to options on GNMA's. The court determined that no other provision of the securities laws granted the SEC substantive power over GNMA options.

In deciding No. 81-2587, the court found that no significant differences existed between the jurisdictional issues presented by the SEC's order approving the CBOE rule changes and the order approving the OCC rule changes, and accordingly set aside the latter order for the same reasons enunciated in its opinion in No. 81-1660.

The court denied petitions for rehearing and suggestions for rehearing *en banc* on May 27, 1982. No member of the court of appeals, not even dissenting Judge Cudahy, requested a rehearing *en banc*. CBOE and OCC petitioned this Court for a writ of certiorari on August 25, 1982, and the Solicitor General submitted a petition on behalf of the SEC on September 24, 1982.

While Nos. 81-1660 and 81-2587 were pending before the court of appeals, the CFTC and SEC reached an agreement on the jurisdictional issues at stake in these cases (the "Accord"), and submitted proposed implementing legislation to Congress which would codify the terms of the Accord by transferring jurisdiction over options on commodities/exempted securities (*e.g.*, GNMA's) from the CFTC to the SEC.[5] The legislative package was composed of amendments to both the CEA, contained in the Futures Trading Act of 1982 (H.R. 5447, 97th Cong., 2d Sess. (1982)) ("CEA Amendments"), and the securities laws, contained in the Securities Acts Amendments (H.R. 6156, 97th Cong., 2d Sess. (1982)) ("Securities Amendments"). Title I of the CEA Amendments would

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[5] The lower court held that the Accord in and of itself did not moot the issues in Nos. 81-1660 and 81-2587 because the CFTC and SEC could not alter their statutorily mandated jurisdictions, and that Congressional action was necessary to implement the Accord.

overrule the appeals court's first ground of decision,[6] and the Securities Amendments would alter the court's second ground.[7] The Securities Amendments were enacted on October 13, 1982. Slightly different versions of the CEA Amendments were passed by the House and Senate on September 23 and October 1, respectively,[8] and the two bills are scheduled to go to conference committee early in the post-election session of Congress beginning November 29.

On October 14, 1982, the SEC approved rule changes of CBOE, the American Stock Exchange, Inc. ("Amex"), and OCC which would permit the trading of exchange-formed off-set options on GNMA's and Treasury instruments. Securities Exchange Act Release No. 19125, 47

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[6] The CEA Amendments of relevance here would modify the exclusive jurisdiction granted in CEA § 2(a)(1) (redesignated 2(a)(1)(A)) with the proviso "except to the extent otherwise provided in subparagraph (B) of this paragraph." Subparagraph (B) states that "Notwithstanding any other provision of law—(i) This Act shall not apply to . . . any transaction whereby any party acquires any put, call or other option on one or more securities . . . ." *See* Title I, H.R. 5447, 97th Cong., 2d Sess. (1982) (House version). The Senate version of H.R. 5447 does not differ with respect to these provisions. *See* 128 Cong. Rec. S13104 (daily ed. October 1, 1982). The legislation thus explicitly amends the exclusive jurisdiction clause to remove the CEA's previous preemption of SEC authority regarding options on securities.

[7] The Securities Amendments redefine security in Section 3(a)(10) of the SEA to include "any put, call, straddle, option or privilege on any security . . . or entered into on a national securities exchange relating to foreign currency." In addition, SEA § 9(f) is amended to eliminate the previous withholding of SEC authority over options on exempt securities. A new § 9(g) is added, stating: "Notwithstanding any other provision of law, the [SEC] shall have the authority to regulate the trading of any options on a security . . . ." Conforming amendments to the other securities laws are also made.

[8] *See* 128 Cong. Rec. H7472-7523 (daily ed. September 23, 1982); 128 Cong. Rec. S13064-13114 (daily ed. October 1, 1982). *See also* note 6 *supra*.

Fed. Reg. 46,934 (1982). In response thereto, the Board of Trade filed a petition with the Seventh Circuit Court of Appeals, No. 82-2659, challenging the orders approving the rule changes. The Board of Trade requested an emergency stay of the SEC's orders, in light of the announced intention of CBOE and Amex to begin trading in the newly authorized options on October 22, 1982. The court refused to issue the temporary stay,[9] on the ground that "H.R. 6156 [the newly enacted Securities Amendments] grants the Securities and Exchange Commission jurisdiction under the securities laws to authorize options on government securities." *Board of Trade v. SEC*, No. 82-2659 (7th Cir. Oct. 21, 1982) (order denying motion for reconsideration *en banc*). Trading in options on Treasury instruments on CBOE and Amex has begun as scheduled.

Previously, on October 15, 1982, the Solicitor General filed a Memorandum Suggesting Mootness, and CBOE and OCC have filed a memorandum to the same effect. This brief represents the respondent Board of Trade's response to the petitions and the memoranda.

REASONS FOR DENYING THE WRIT

I. BECAUSE THE PETITIONERS HAD A FULL AND FAIR OPPORTUNITY TO LITIGATE, THE COURT OF APPEALS' JUDGMENT SHOULD STAND EVEN THOUGH THE CASE IS NOW MOOT AS A PRACTICAL MATTER.

The Board of Trade recognizes that this case has been mooted as a practical matter. Enactment of the Securities Amendments has codified SEC authority over options—and in such a manner that, as recently as Octo-

[9] The Board of Trade's motion for an emergency stay was denied by an order dated October 21, 1982. The same day, the Board of Trade filed an emergency motion for reconsideration *en banc* of the stay motion, and the court of appeals, acting *en banc*, denied the motion for the reason stated above.

ber 21, the court of appeals declined to stay the opening of options markets similar to the market at issue in this case.[10] In addition, the SEC has issued new orders which permit the trading of GNMA options on CBOE. These orders, issued pursuant to the authority newly granted by the Securities Amendments, supersede the orders that were at issue in Nos. 81-1660 and 81-2587. Finally, trading in options on financial instruments has begun on the CBOE under the new SEC orders.

The petitioners now argue that certiorari should be granted in order for the Court to vacate the judgment of the court below because of the developments outlined above. The Board of Trade disagrees and respectfully urges the Court to deny the petitions.

In support of their request, petitioners rely on *Great Western Sugar Co. v. Nelson*, 442 U.S. 92 (1979), and *United States v. Munsingwear, Inc.*, 340 U.S. 36 (1950). However, these cases do not require the Court to vacate the judgment of the court of appeals. Rather, both cases hold only that a *court of appeals* is required to vacate the judgment of a *district court* when the decision of the district court becomes moot pending appellate review. Although there is dictum in *Munsingwear* to the effect that the Supreme Court also "normally" [11] vacates a lower court's judgment when the case becomes moot awaiting decision, nowhere does the opinion state that this Court is required to vacate the judgment of a court of appeals, and indeed it admits of exceptions to the so-called "normal" practice. 340 U.S. at 40 n.42.

Contrary to petitioners' argument, *Munsingwear* and its progeny indicate that the appellate court's decision in

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[10] It should also be noted that the amendments also have resolved many of the concerns raised by petitioners in their arguments for a grant of certiorari—that the lower court's opinion endangered the existing stock options exchanges and created regulatory gaps.

[11] *City of Mesquite v. Aladdin's Castle, Inc.*, No. 80-1577, 50 U.S.L.W. 4210, 4211 n.9 (1982).

the instant case should stand. *Munsingwear* makes plain that a court of appeals must vacate the district court's judgment for mootness only because prior to conclusion of the initial appeal, the parties have not had a full and fair chance to litigate within the statutory scheme:

> [Vacating the district court's opinion] clears the path for future relitigation of the issues between the parties and eliminates a judgment, review of which was prevented through happenstance. When the procedure is followed, the rights of all parties are preserved; none is prejudiced by a decision which in the statutory scheme was only preliminary. . . . [In summary, the vacation procedure] is commonly utilized . . . to prevent a judgment, unreviewable because of mootness, from spawning any legal consequences.

340 U.S. at 40.

Here, the petitioners have been given all the review provided for by the relevant "statutory scheme" [15] and indeed all the review required by a full and fair opportunity to litigate.[16] Thus, prior to becoming moot, the

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[15] Section 25(a)(1) of the Securities Exchange Act of 1934, 15 U.S.C. § 78y(a)(1), provides for review of SEC orders in a court of appeals. Nothing in the securities laws, however, provides for mandatory review by this Court, nor could petitioners expect such review as of right.

[16] Certiorari review is not a necessary element of a full and fair opportunity to litigate because it is fundamentally different from the statutory right to be heard by a court of appeals. *See* Note, *Collateral Estoppel and Supreme Court Disposition of Moot Cases*, 78 Mich. L. Rev. 946, 953-58 (1980). "A review on writ of certiorari is not a matter of right, but of judicial discretion," Supreme Court Rule 17; a writ of certiorari is reserved for "passing upon constitutional and other important questions of law for the public benefit." *Hearings Before the Comm. on the Judiciary of the House of Representatives on H.R. 10479*, 67th Cong., 2d Sess. 2 (1922) (remarks of Chief Justice Taft), *quoted in Dick v. New York Life Ins. Co.*, 359 U.S. 437, 452 (1959) (Frankfurter, J., dissenting). Certiorari review is not meant to correct the peculiar injustices that

dispute was fairly and finally resolved according to the statutory scheme for review of SEC orders. This Court should not mechanically undo that resolution. Moreover, the mootness here did not occur by "happenstance" but rather through deliberate legislative and subsequent regulatory actions prompted by the petitioners themselves. Petitioners cannot be heard to argue now that their own actions in proposing and promoting legislation to moot the controversy require this Court to vacate the judgment of the court of appeals.[14]

Finally, because the Board of Trade does not intend to pursue the related cases filed in the Seventh Circuit, and because the statutory language relied on by the court of appeals has been changed, the opinion below cannot "spawn any [untoward] legal consequences." Concern about res judicata effects is unwarranted because the same dispute between the Board of Trade and the petitioners cannot recur under the new statutes. Collateral estoppel effects are of doubtful importance because no issues determined by the court of appeals are likely to affect either the Board of Trade or the petitioners.[15] By

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may have been suffered by particular litigants but rather "to develop uniform national rules of law that meet the needs of a changing society." Note, *supra*, 78 Mich. L. Rev. at 955. Furthermore, this case may be distinguished from cases that become moot after certiorari has been granted. Where certiorari already has been granted, the Court has indicated its desire to reopen the issue and the petitioner may have an expectancy of the further opportunity to litigate. Where a case becomes moot before certiorari is granted, however, the Court has not yet addressed the dispute, and the petitioner has no expectancy of further litigation. Therefore, by its appearance before the court of appeals below, the SEC has had a full and fair opportunity to litigate which is unaffected by pre-certiorari mootness of the controversy.

[14] *Compare City of Mesquite v. Aladdin's Castle, Inc.*, 50 U.S.L.W. at 4211 (deliberate legislative attempt to moot controversy held ineffective).

[15] Because the court of appeals stayed the SEC orders under review pending its decision, there was never any trading of the

denying certiorari, the Court does not stamp its approval on the court's opinion. In the unlikely event that the decision below is relied upon in some subsequent, live controversy, this Court then will have the opportunity to review its correctness.[16] Therefore, the concerns expressed in *Munsingwear* are not present here, and its reasons for vacating a lower court's judgment are inapplicable.

The Court previously has permitted exceptions to the *Munsingwear* procedure, as it did *sub silentio* in *Velsicol Chemical Corporation v. United States*, 435 U.S. 942 (1978) and *Local 102, International Ladies' Garment Workers' Union v. United States*, 439 U.S. 1070 (1979). Each case was mooted after review by the court of appeals but prior to a decision on the petition for certiorari,[17] and in each case the Solicitor General argued that it would be unfair to vacate the lower court opinion because the petitioning party had received a full and fair opportunity to litigate the dispute prior to mootness.[18] The Court in both cases denied certiorari without stating

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GNMA options, and thus there is no possibility now of private lawsuits against the CBOE or OCC based on what would have been illegal trading.

[16] *See Alabama v. Davis*, 446 U.S. 903, 904 (1980) (Stevens, J., dissenting).

[17] In *Velsicol*, a lawyer was ordered to testify before and produce documents to a grand jury regarding matters he asserted were protected by the attorney-client privilege. The district court nevertheless ordered the lawyer to testify and the court of appeals affirmed. The lawyer then decided to seek a writ of certiorari, but because his motions for a stay of the court of appeals' mandate were denied, he was forced to testify and produce the required documents before filing his petition for certiorari.

The facts in *International Ladies'* are in pertinent respects the same.

[18] *See* Brief For the United States in Opposition at 4-8, *Velsicol Chem. Corp. v. United States*, 435 U.S. 942 (1978); Memorandum For the United States in Opposition at 4 n.4, *Local 102, Int'l Ladies' Garment Workers' Union v. United States*, 439 U.S. 1070 (1979).

its reasons, leaving the lower court opinions intact. Because of the similarity in situation, the same procedure should be followed here.[19]

If this Court were to routinely vacate decisions intentionally mooted by subsequent legislation, courts of appeals would have less incentive to be as thorough in deciding cases where new legislation is imminent and parties would have less incentive to vigorously pursue their appeals. As a result, both the judicial system and the legislative process would be subject to manipulation—to the detriment of an already overloaded court system.

II. THE DECISION OF THE COURT OF APPEALS WAS CORRECT UNDER THE THEN EXISTING STATUTES.

Even though the case now appears to be moot as a result of legislative and regulatory actions occurring after the parties had a full and fair opportunity to litigate, the court of appeals correctly interpreted the securities and commodities laws as they stood at the time of decision.[20] Thus, the Court should not vacate the decision but should simply deny certiorari.

In vacating the orders of the SEC in Nos. 81-1660 and 81-2587, the court of appeals correctly concluded that the CFTC had exclusive jurisdiction over the trading of GNMA options. GNMA's are commodities for the purposes of section 2(a)(1) of the CEA, 7 U.S.C. § 2 (1976), because futures contracts on GNMA's are traded through the facilities of the respondent Board of Trade, as they have been since 1975. GNMA's also are exempted

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[19] *See also Dove v. United States*, 423 U.S. 325 (1976) (petition for certiorari dismissed but lower court judgment not vacated when petitioner died).

[20] The bulk of petitioners' arguments regarding the appellate court's interpretation of the securities laws is now irrelevant in view of the Securities Amendments, and such arguments provide no basis for certiorari.

securities under Section 3(a)(12) of the SEA, 15 U.S.C. § 78c(a)(12), (1976), and the SEC traditionally has not exercised significant regulatory authority over them.[21]

The CEA explicitly bans options on commodities—without limitation as to whether the commodity is also a security—unless traded pursuant to the regulations of the CFTC,[22] and grants the CFTC exclusive authority over options "involving" futures contracts.[23] The CEA thus explicitly provides a comprehensive scheme for the regulation of both futures and options on the same underlying instrument. By contrast, the only provision of the SEA that dealt explicitly with options expressly withheld

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[21] As exempted securities, GNMA's are not subject to the registration requirements of the SEA. Moreover, the formation of and over-the-counter trading in GNMA's are primarily regulated by the Department of Housing and Urban Development, the Treasury Department, and the Federal Reserve Board, with the SEC's role limited to antifraud enforcement. *See Report of the Joint Treasury-SEC-Federal Reserve Study of the Government-Related Securities Markets*, Senate Comm. on Banking, Housing, and Urban Affairs, 96th Cong., 2d Sess. 1, 105-06, 176-78 (Comm. Print 1980); Letter to the Hon. Patrick J. Leahy, Senate Subcomm. on Agricultural Research and Legislation, from Robert Carswell, Deputy Secretary of the Treasury (April 13, 1978), *reprinted in* S. Rep. No. 850, 95th Cong., 2d Sess. 49 (1978) *reprinted in* 1978 U.S. Code Cong. & Ad. News 2087, 2137.

[22] CEA § 4c(b), (c), 7 U.S.C. § 6c(b), (c) (1976 & Supp. II 1978).

[23] CEA § 2(a)(1), 7 U.S.C. § 2 (1976). The CFTC has plenary authority to regulate options under section 4c(a) and 4c(b) of the CEA. Section 4c(a) prohibits transactions in the commodities specifically enumerated in section 2(a)(1) which may be used for hedging or price discovery and which are "of the character of" options. Section 4c(b) prohibits "any transaction subject to the provisions of paragraph (a) of this section" that involves a commodity not specifically enumerated in section 2(a)(1) and that is an option. Thus, section 4c(b) incorporates the key functions for which the commodity could be used (hedging and price discovery) as defining the commodity option transaction subject to section 4c(b).

from the SEC authority to regulate options on exempted securities.[24]

Faced with these statutory schemes, the majority of the court below correctly assessed that Congress intended the CFTC to regulate options on exempted securities where a futures contract on the underlying instrument was already regulated by the CFTC.[25] In addition to the clarity of language on the face of the statutes, the evidence from the legislative history overwhelmingly supports the court's interpretation of congressional intent.

For example, Congress itself said that section 4c of the CEA applied to options on "new" commodities such as GNMA's.[26] In 1974 and again in 1978, Congress drew

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[24] *See* SEA § 9(b), (f), 15 U.S.C. § 78i(b), (f) (1976).

[25] The court relied on this Court's analysis in *International Brotherhood of Teamsters v. Daniel*, 439 U.S. 551 (1979), which held that an instrument (there, a pension plan) will not be deemed a "security" in the face of an alternative regulatory framework.

[26] *See, e.g.*, S. Rep. No. 850, 95th Cong., 2d Sess. 22, *reprinted in* 1978 U.S. Code Cong. & Ad. News at 2110:

> The action Congress took in 1974 reflects the congressional awareness that futures markets would not remain static . . . . Specifically, Congress was aware in 1974 that proposals for futures trading in financial instruments and Government securities were being developed.
>
> The wisdom of these decisions is evident in rapid development and acceptance of futures markets in both GNMA mortgage-backed securities and United States Treasury bills.
>
> These are not commodities in the traditional sense. However, the need and utility of futures markets in these commodities to hedge against inflation and market uncertainty, as well as aid in market arbitrage, is evident.

Accord, id. at 13-14, 1978 U.S. Code Cong. & Ad. News at 2101-02; H.R. Rep. No. 1181, 95th Cong., 2d Sess. 12 (1978).

In 1978, in addition to reauthorizing the CFTC, Congress enacted the ban on commodity options contained in CEA § 4c(c), 7 U.S.C. § 6c(c) (Supp. II 1978). The evidence from 1978 of congressional intent concerning the regulation of options on financial instruments is thus directly relevant to the interpretation of the CEA.

the line between CFTC and SEC jurisdiction through the so-called "SEC savings clause" by preserving SEC jurisdiction over instruments traditionally regulated by the SEC, *i.e.*, *corporate* securities and options thereon.[27] The SEC twice sought and failed to obtain from Congress an express exemption for "securities" from the definition of "commodities."[28] This legislative background thus rebuts petitioners' contention that there was an implied exemption from CFTC regulation for options on all securities that are commodities.[29]

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[27] For example, Representative Poage, Chairman of the House Committee on Agriculture stated: "[The CEA] was not intended, however, to apply to trading in interests and rights traditionally known as securities, including, for example, stocks, *corporate* bonds, warrants, and debentures, nor was it intended to apply to trading in options to purchase any of the foregoing." 120 Cong. Rec. 34737 (1974) (emphasis added).

Again, in 1978, the Senate Report noted the essential differences between registered and exempted scurities, stating:

> Put and call options to sell or purchase *individual exchange-traded industrial equities* are now traded on securities exchanges. Regulation of these options is under the jurisdiction of the SEC, which regulates the exchanges on which these options are traded and *oversees a comprehensive system of disclosure by the issuers of the underlying industrial equities.*

S. Rep. No. 850, 95th Cong., 2d Sess. 21-22 (1978) (emphasis added), *reprinted in* 1978 U.S. Code Cong. & Ad. News 2087, 2109-10. It was thus recognized that SEC regulatory jurisdiction over options derived from the regulatory authority over the underlying industrial equities.

[28] *Board of Trade v. SEC*, Appendix at A-25, A-26.

[29] The report of the House Agriculture Committee accompanying the Securities Amendments—which were designed to alter the lower court's decision—affirmed that the court reached the correct conclusion but that more pragmatic considerations warrant a change in the jurisdictional structure:

> [The Seventh Circuit's] conclusion is consistent with the policy expressed by Congress in the past in providing CFTC with regulatory authority over hedging and price-discovery instruments

Although the petitioners criticize the court for its conclusion that options "involve" future contracts on the same underlying instrument within the meaning of CEA § 2(a)(1), the SEC itself in testimony to Congress in 1978 emphasized the interdependence of options and futures and recognized the necessity for uniform regulation of them.[30] In rejecting the SEC's legislative initiative in 1978 to transfer regulatory authority over futures and options on "securities" that are also commodities, the Congress reaffirmed the CFTC's authority to regulate these contracts.[31]

The so-called "Treasury amendment," offered by the Treasury to exempt bank and other financial institutions' transactions in the "cash" market in various instruments, originally included "puts and calls on securities" as one of the items over which CFTC jurisdiction

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and the SEC with the burden of protecting the efficiency and fairness of the capital formation market.

* * *

While the Committee continues to believe that this functional breakdown serves important public purposes, it recognizes the pragmatic consideration that the public will be best served by ending the jurisdictional dispute between the two agencies and supporting the enactment of [sic] law of the jurisdictional accord reached voluntarily by the CFTC and the SEC.

H.R. Rep. No. 626, Part 2, 97th Cong., 2d Sess. 2 (1982).

[30] *See Board of Trade v. SEC*, Appendix at A-30 n.28, A-31 n.29 (quoting testimony of SEC Chairman Williams).

[31] Moreover, Congress recognized that commodities trading, whether by options or futures, provides hedging and risk-shifting functions whereas securities trading involves the capital formation process, and that different types of regulation were required for each. Thus, the 1974 House Report stated that "the concepts of margin . . ., the actual delivery of commodities in certain limited situations . . ., *and the handling of devices such as options are, and should remain, entirely different within the respective spheres of regulation.*" H.R. Rep. No. 975, 93d Cong., 2d Sess. 71 (1974) (emphasis added). *See also* note 27 *supra*.

was withheld. In limiting the scope of the exemption to cash market transactions by financial transactions, "puts and calls" were deleted.[32]

Thus, aside from the clarity of the statutory scheme itself, the evidence is overwhelming that Congress intended in 1974 and 1978 for the CFTC—and not the SEC—to exercise jurisdiction over off-set options on exempted securities that were also commodities.[33]

The court's conclusion that the 1974 and 1978 amendments to the CEA granted the CFTC authority to regulate off-set options on exempt securities is the major holding of the case. As an alternate holding, the court

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[32] *See Board of Trade v. SEC*, Appendix at A-35. Moreover, the Senate Committee, which added the Treasury Amendment, emphasized its limited scope: "[T]he Committee amendment provides that *interbank trading* of foreign currencies and specified financial instruments is not subject to CFTC regulation." S. Rep. No. 1131, 93d Cong., 2d Sess. 6 (1974) (emphasis added), *reprinted in* 1974 U.S. Code Cong. & Ad. News at 5848. The congressional focus in adopting the Treasury amendment was to avoid subjecting "transactions . . . between banks and other sophisticated institutional participants" to the CEA; regulation by the CFTC was "unnecessary," because these transactions were already "regulated by the bank regulatory agencies." *Id.* at 23, 26, *reprinted in* 1974 U.S. Code Cong. & Ad. News at 5864, 5866. *See CFTC v. American Board of Trade*, 473 F. Supp. 1177 (S.D.N.Y. 1979) (holding that Treasury amendment does not preclude CFTC regulation of options on foreign currency); *CFTC v. Sterling Capital Co.*, 2 Comm. Fut. L. Rep. (CCH) ¶ 21,169 (N.D.Ga. 1981) (same).

[33] One of the arguments made by CBOE and OCC in their petition for certiorari is that the SEA is a "better" regulatory scheme than the CEA and that the SEC is a better regulator than the CFTC. Such arguments, of course, have no bearing on the legal question of statutory interpretation as was presented in this case. *See Board of Trade v. SEC*, Appendix at A-50, A-64-A-65. In addition, it should be noted that the CEA has important protections not contained in the SEA—such as reparations procedures and civil penalty authority—and that the CFTC won praise from Congress in 1978 for its handling of the futures markets in GNMA's and other exempted securities. *See* note 26 *supra*.

determined that under the SEA the SEC had no authority in the first instance to regulate such options. This holding was buttressed both by the terms of the statute itself and by the SEC's own actions.[84]

The only express grant of substantive SEC power over options at the time of decision was contained in section 9(b), and section 9(f) withheld this grant with respect to options on *exempted* securities—like GNMA's. Moreover, as found by the court of appeals, the SEC had consistently relied on section 9(b) for its regulatory authority over stock options.[86] For example, when the SEC first authorized the CBOE stock options market in 1973, it relied only on Section 3(a)(11) in addition to 9(b).[86] Section 3(a)(11) does permit the SEC certain freedoms in defining the term "equity security," a power withheld in section 3(a)(10) with respect to the term "security." But GNMA's were not equity securities,[87] and therefore under the SEC's own interpretation of its power, it had none to authorize trading of GNMA options.

Thus, the SEC itself had evidenced through its actions the interpretation that its regulatory power over options derived from its regulatory power over the underlying instrument. Indeed, Congress in 1978 explicitly confirmed this analysis while reaffirming CFTC exclusive jurisdiction and enacting CEA § 4c(c).[88] When the court

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[84] And, again, the possibly adverse effects of this holding catalogued in the petitions for certiorari are of no possible concern now that the Securities Amendments are law. Thus, the primary reasons petitioners have advanced for granting certiorari no longer appertain.

[86] *See Board of Trade v. SEC*, Appendix at A-47.

[86] *See* SEA Release No. 9930 (1973), [1972-1973] Fed. Sec. L. Rep. (CCH) ¶ 70,171 (rule 9b-1); SEC Rule 3a11-1, 17 C.F.R. § 240.3a11-1 (1981) (defining an option on an equity security as an equity security).

[87] *Board of Trade v. SEC*, Appendix at A-45 n.45.

[88] *See* note 27 *supra*.

acted, the SEC had no regulatory authority over GNMA's and therefore had no regulatory authority over GNMA options.

Section 3(a)(10)—the primary SEA definition of "security"—provided the final confirmation that the SEC had no regulatory authority over options without reference to the underlying instrument. Although Congress in 1934 was well aware of options—witness section 9(b)—it chose not to include "options" by name within the many terms used in the section. "Moreover, the other terms included in the section did not encompass exchange-formed off-set options. Petitioners' reliance on the phrase "instrument commonly known as a security" is unavailing because it has been interpreted to have the same meaning as the phrase "investment contract" [39] and because the introductory phrase to the section—"unless the context otherwise requires"—provides a significant limitation. Since Congress chose not to include options in section 3(a)(10) but rather granted the SEC authority through a separate section, § 9(b), and since Congress also enacted a separate, comprehensive regulatory scheme governing options on exempted securities such as GNMA's in the CEA, the "context" clearly required that the otherwise unbounded reach of "instrument commonly held to be a "security" be held not to include GNMA options.

The lower court thus correctly decided the issues before it. The legislative history incontrovertibly demonstrates that Congress in 1974 and 1978 intended futures and options on the same underlying instrument to be regulated by a single agency, the CFTC. Moreover, as evidenced by the SEA and related SEC actions, SEC authority over options was based on regulatory authority over the underlying instrument, and it thus had no authority in its own right over GNMA options.

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[39] *See Board of Trade v. SEC*, Appendix at A-43, *quoting United Housing Foundation, Inc. v. Forman*, 421 U.S. 837 (1975).

CONCLUSION

The Court of Appeals correctly decided the narrow question of statutory construction posed by this case. For the reasons stated above, the respondent Board of Trade respectfully requests the Court to deny the petitions for writ of certiorari.

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ALEXANDER L. STEVAS,

No. 82-327

In the Supreme Court of the United States

OCTOBER TERM, 1982

CHICAGO BOARD OPTIONS EXCHANGE, INCORPORATED

and

THE OPTIONS CLEARING CORPORATION,
Petitioners,

v.

BOARD OF TRADE OF THE CITY OF CHICAGO,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

PETITIONERS' REPLY BRIEF IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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CHICAGO BOARD OPTIONS EXCHANGE, INCORPORATED

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PETITIONERS' REPLY BRIEF IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

Petitioners, Chicago Board Options Exchange, Incorporated ("CBOE") and The Options Clearing Corporation ("OCC"),[1] submit this reply in response to certain new arguments raised by the respondent, Board of Trade of the City of Chicago ("Board of Trade"), in the opposing brief ("Resp. Br.") that it filed herein on November 1, 1982.

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[1] Pursuant to Rule 28.1 of the Rules of this Court, CBOE and OCC state that they have no parent companies, subsidiaries (other than wholly owned subsidiaries) or affiliates.

1. All parties in this proceeding and in the related proceeding (No. 82-526) filed herein by the Solicitor General on behalf of the Securities and Exchange Commission ("SEC") agree that these cases are moot.[2] Thus, the only question remaining is how the petitions for writ of certiorari should be handled. The SEC, CBOE and OCC have urged the Court to follow its "established practice" by granting the petitions, vacating the judgments of the court of appeals and remanding the cases with directions to dismiss the petitions for review as moot. *United States* v. *Munsingwear, Inc.*, 340 U.S. 36, 39 (1950). The Board of Trade, however, has asked the Court to create an exception to the *Munsingwear* procedure and to deny the petitions for writ of certiorari. (Resp. Br. 6-11).

2. The Court in *Munsingwear,* 340 U.S. at 41, explained that the reason for vacating a lower court's judgment when a case has become moot is to prevent the judgment, "unreviewable because of mootness, from spawning any legal consequences." The Board of Trade asserts that that reason does not apply here because (1) it "does not intend to pursue the related cases filed in the Seventh Circuit"[3] and (2) "no issues determined by the court of appeals

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[2] *See* Memorandum for the Securities and Exchange Commission Suggesting Mootness filed in No. 82-526 on October 18, 1982; Memorandum of the Chicago Board Options Exchange, Incorporated and The Options Clearing Corporation Suggesting Mootness filed herein on November 1, 1982; and Resp. Br. at 6-7.

[3] There are two related cases pending in the Seventh Circuit. One (No. 82-1097) was instituted by the Board of Trade and the Chicago Mercantile Exchange to review an SEC order which had approved rules of CBOE and the American Stock Exchange ("AMEX") proposing trading on those exchanges of options on securities issued by the United States Department of the Treasury ("Treasury options"). The other (No. 82-2659) was instituted by the Board of Trade to review SEC orders which had approved rules of CBOE, OCC and AMEX relating to Treasury options and options on securities guaranteed by the Government National Mortgage Association ("GNMA options"). The rules relating to GNMA options at issue in No. 82-2659 are essentially the same as the rules at issue in the two cases that are the subject of the petitions for writ of certiorari.

are likely to affect either the Board of Trade or the petitioners." (Resp. Br. 9). These assertions, however, are simply not supportable. As discussed below, the legal consequences spawned by the judgments of the court of appeals could adversely affect CBOE and OCC.

First, the Board of Trade has refused to rule out the possibility that it may continue to litigate related issues against CBOE and OCC. On November 1, 1982, the Board of Trade filed motions to dismiss "without prejudice" the petitions for review in the two cases still pending in the Seventh Circuit. CBOE, AMEX and OCC filed a response in No. 82-2659 requesting that the petition for review therein be dismissed with prejudice. In its reply dated November 8, 1982, the Board of Trade opposed a dismissal with prejudice because it refused "to be estopped to argue that the current trading [of Treasury options on CBOE and AMEX] is illegal in some as yet unforeseen proceeding." Thus, since the related litigation between the Board of Trade, on the one hand, and the SEC, CBOE and OCC, on the other, may not yet be over, it is important to CBOE and OCC that their petition for certiorari be granted and the judgments below vacated so that the Board of Trade cannot argue in related litigation that those judgments have some collateral estoppel or res judicata effect against the SEC, CBOE and OCC.

More importantly, the judgments below should be vacated in order to prevent participants in the securities options market from claiming that the SEC, CBOE and OCC are estopped from relitigating the issues decided adversely to them. Among other things, the Seventh Circuit held (Pet. App. A-37 to A-45)[4] that exchange-traded securities options were not "securities" as then defined in Section 3(a)(10) of the Securities Exchange Act of 1934

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[4] "Pet. App." refers to appendix to the petition for a writ of certiorari filed herein by CBOE and OCC on August 25, 1982.

(the "Exchange Act"), 15 U.S.C. § 78c(a)(10) (1976).[5] As discussed in the petition for a writ of certiorari filed herein at pp. 13-17, this holding, if allowed to stand, would severely disrupt the established regulatory scheme pertaining to securities options. Although the recent enactment of Pub. L. No. 97-303 has alleviated this problem prospectively, the problem still exists with respect to prior actions taken under rules that were adopted on the understanding that exchange-traded options were "securities" under the Exchange Act prior to the enactment of Pub. L. No. 97-303.

For example, Regulation T of the Board of Governors of the Federal Reserve System ("Board")[6] was promulgated pursuant to the authority granted to the Board under Section 7 of the Exchange Act, 15 U.S.C. § 78g, to adopt regulations pertaining to credit extended *on securities*. Thus, a broker-dealer charged with violating the options provisions of Regulation T prior to the enactment of Pub. L. No. 97-303 could assert as a defense that the Board lacked statutory authority to establish margin requirements for options on the basis of the holding below that options were not securities. Indeed, if the SEC or CBOE were to bring a disciplinary action against the broker-dealer for violating Regulation T,[7] the broker-dealer could argue that they were estopped, under the doctrine of collateral estoppel,[8] from relitigating the

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[5] The recent enactment of Pub. L. No. 97-303, 96 Stat. 1409, has clarified the definition of "security" so that it now includes explicitly "any put, call, straddle, option, or privilege on any security." The text of Pub. L. No. 97-303 is reprinted in the appendix to the Memorandum for the Securities and Exchange Commission Suggesting Mootness filed by the Solicitor General in No. 82-526 on October 18, 1982.

[6] Among other things, Regulation T establishes margin requirements for broker-dealers with respect to options positions held in a customer's margin account. 12 C.F.R. § 220.3(i).

[7] The SEC is responsible for enforcing compliance with the rules and regulations adopted under the Exchange Act (including Regulation T) under Section 21 of the Exchange Act, 15 U.S.C. § 78u. CBOE has a statutory duty to enforce compliance by its members with such rules and regulations under Section 19(g) of the Exchange Act, 15 U.S.C. § 78s(g).

[8] *See Parklane Hosiery Co.* v. *Shore*, 439 U.S. 322, 326-33 (1979).

issue of whether an exchange-traded option fell within the pre-Pub. L. No. 97-303 definition of "security." The need to prevent such legal consequences from being spawned is a compelling reason to follow the *Munsingwear* procedure in this case.

3. The Board of Trade argues that the petitions for certiorari should be denied because the parties had a "full and fair opportunity" to litigate the issues in the Seventh Circuit and that court (the Board of Trade contends) correctly decided those issues. (Resp. Br. 6-19). Although CBOE and OCC dispute the correctness of the Seventh Circuit decisions, no purpose would be served by having this Court consider the merits of a case that everyone agrees is now moot. The Board of Trade cites no authority for the proposition that this Court has recognized an exception to the *Munsingwear* procedure in cases where the parties have had a "full and fair opportunity" to litigate in the court of appeals. To the contrary, the Court has expressly followed the *Munsingwear* procedure in numerous cases where there had been a full adjudication of the issues in the court of appeals.[9] Similarly, the Board of Trade's attempt to distinguish this case from cases that became moot after certiorari had been granted (Resp. Br. 8-9 n.13) finds no support in this Court's decisions, while there are many examples of cases in which the Court followed the *Munsingwear* procedure when the mooting event occurred before the Court's decision on certiorari.[10]

The Board of Trade also seeks to create an exception to the *Munsingwear* procedure for this case because the mooting event occurred "through deliberate legislative and subsequent regulatory actions prompted by the petitioners themselves." (Resp. Br. 9). Although it is true that the SEC, CBOE and OCC supported the legislation that became Pub. L. No. 97-303, so also did the

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[9] *See, e.g., County of Los Angeles* v. *Davis*, 440 U.S. 625 (1979); *Weinstein* v. *Bradford*, 423 U.S. 147 (1975); *Preiser* v. *Newkirk*, 422 U.S. 395 (1975).

[10] *See, e.g., Alabama* v. *Davis*, 446 U.S. 903 (1980); *Connecticut State Board of Parole* v. *Bey*, 404 U.S. 879 (1971); *Cozart* v. *Wilson*, 352 U.S. 884 (1956); *SEC* v. *Harrison*, 340 U.S. 908 (1951).

Commodity Futures Trading Commission ("CFTC"), the securities industry and the commodities industry.[11] In its report recommending enactment of the legislation, the House Committee on Energy and Commerce expressed its view that the decision below by the Seventh Circuit was in error,[12] and the floor leaders of the legislation in both the House and Senate debates stated that the legislation was intended to overturn the Seventh Circuit decision.[13] Thus, the circumstances surrounding the enactment of Pub. L. No. 97-303 do not support the creation of an exception to the *Munsingwear* procedure; to the contrary, they underscore the need to vacate the judgments below, which Congress expressly determined to overturn.

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[11] *See* H.R. Rep. No. 626, Part 2, 97th Cong., 2d Sess. 4 (1982) (noting that the jurisdictional accord between the SEC and the CFTC, part of which was enacted as Pub. L. No. 97-303, "has the support of both the futures industry and the securities industry, the Chairman [sic] of the CFTC and the SEC and of the Administration").

[12] The House Committee stated its belief that put and call options on securities were themselves securities and that the Seventh Circuit decision was "not consistent with long-standing Congressional intent ...." H.R. Rep. No. 626, Part 1, 97th Cong., 2d Sess. 3, 8 (1982).

[13] *See* 128 Cong. Rec. H7476-77 (daily ed. Sept. 23, 1982) (remarks of Representative Dingell, Chairman of the House Committee on Energy and Commerce); 128 Cong. Rec. S13112 (daily ed. Oct. 1, 1982) (remarks of Senator D'Amato, Chairman of the Subcommittee on Securities of the Senate Committee on Banking, Housing, and Urban Affairs).

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

Nos. 82-327, 82-526

CHICAGO BOARD OPTIONS EXCHANGE, INCORPORATED, *et al.*,
Petitioners,

v.

BOARD OF TRADE OF THE CITY OF CHICAGO,
Respondent.

BRIEF IN RESPONSE TO PETITIONERS' REPLY BRIEF

Respondent Board of Trade of the City of Chicago ("Board of Trade")[1] submits this brief response to two new arguments which petitioners Chicago Board Options Exchange, Inc. and Options Clearing Corporation, Inc. raise in their reply brief (filed November 15, 1982) as reasons for vacating the decision below.

1. In a one-sided review of the legislative statements accompanying the recent enactment of Pub. L. No. 97-303 (the so-called "Securities Amendments"), petitioners assert that various members of Congress thought the decisions below were in error. Pet. Reply Br. at 6. This supposed evidence of the incorrectness of the lower decisions, petitioners argue, requires this Court to vacate them. But petitioners fail to acknowledge that other members of Congress recognized that the lower court's decisions were indeed correct and that the Securities Amendments worked a fundamental change in the juris-

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[1] Pursuant to Rule 28.1 of the Rules of this Court, the Board of Trade states that it has no parent company, subsidiaries (other than wholly-owned subsidiaries), or affiliates.

dictional allocation between the SEC and the CFTC. For example, the House Committee on Agriculture, to which the Securities Amendments were referred, stated in its report accompanying these Amendments:

> [*The Seventh Circuit's*] *conclusion is consistent with the policy expressed by Congress in the past* in providing CFTC with regulatory authority over hedging and price discovery instruments and the SEC with the burden of protecting the efficiency and fairness of the capital formation market.
>
> * * *
>
> While the Committee continues to believe that this functional breakdown serves important purposes, it recognizes the pragmatic consideration that the public will be best served by ending the jurisdictional dispute between the two agencies . . . .

H.R. Rep. No. 626, Part 2, 97th Cong., 2d Sess. 2 (1982) (emphasis added). *Accord*, H.R. Rep. No. 565, Part 1, 97th Cong., 2d Sess. 40 (1982); 128 Cong. Rec. H7478 (daily ed. Sept. 23, 1982) (remarks of Rep. de la Garza, Chairman, House Committee on Agriculture). Thus, the petitioners are wrong to suggest that "Congress expressly determined to overturn" the lower court decisions because of their incorrectness. Pet. Reply Br. at 6. Rather, as indicated above, a key committee in this process manifestly believed it was overturning the former statute itself, which had been correctly interpreted by the court of appeals.

2. Petitioners also are wrong in arguing that this Court must vacate the decisions of the court of appeals because of Congress' alleged displeasure with the decisions. *See* Pet. Reply Br. at 6. Congress may always rewrite a statute, but it cannot preclude the courts from exercising the "inherently . . . judicial" task of interpreting statutes. *Ex parte Bakelite Corp.*, 279 U.S. 438, 458 (1929). "To declare what the law is, *or has been*, is a judicial power; to declare what the law shall be, is legislative. One of the fundamental principles of all our

governments is, that the legislative power shall be separated from the judicial." *Ogden v. Blackledge*, 6 U.S. (2 Cranch) 272, 277 (1804) (emphasis added). A practice of mechanically vacating lower court decisions in obedience to the latest congressional pronouncements would confer upon Congress the power to overrule statutory interpretations.[2] However, it was early established that the separation of powers doctrine prevents such retrospective overruling of judicial decisions. *Gordon v. United States*, 117 U.S. 697, 702-03 (1864) (published 1886); *Hayburn's Case*, 2 U.S. (2 Dall.) 409, 410-14 (1792).

The court of appeals correctly interpreted the relevant statutes as they stood at the time that it rendered its decisions. The Securities Amendments and the alleged purposes for their enactment do not alter the correctness of the decisions below, and certainly are no basis for this Court to vacate those decisions.

CONCLUSION

Having prevailed upon Congress to change the law and upon the SEC to issue new controlling orders, petitioners now wish to have the entire matter disappear as if it never happened—to rewrite history, so to speak. Petitioners' interest in having the court of appeals' opinion vacated springs from its possible use as a precedent in future cases.[3] Petitioners are requesting the Court to

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[2] Following petitioners' suggested procedure would in effect allow Congress to force vacation of any disagreeable judicial determination simply by amending the relevant statute while a petition for certiorari is pending. Given the Court's heavy workload, there is no room for certiorari petitions filed for the sole purpose of stalling while Congress enacts new legislation to retrospectively overturn decisions of the lower courts. *See Great Western Sugar Co. v. Nelson*, 442 U.S. 92, 94 (1979) (Stevens, J., dissenting).

[3] The Board of Trade agrees the opinion probably will remain a significant precedent for construing the Commodity Exchange Act even if the proposed amendments to the CEA in H.R. 5447 are enacted. For example, the opinion below will prevent the SEC from

destroy this precedent, notwithstanding that they had a full and fair opportunity to litigate the questions involved, whereas the Board of Trade requests only that the Court remain neutral. But petitioners' cries of *Carthago delenda est* are unnecessary. Denial of certiorari does not reflect a judgment as to the merits, and if the lower court opinion is some day important as a precedent, this Court can reflect on its correctness then.

Accordingly, the Board of Trade respectfully requests that the Court deny the petitions for writ of certiorari.

Respectfully submitted,

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Dated: November 19, 1982

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arguing, as it had before, that *futures* on GNMA's are not within the CFTC's exclusive jurisdiction under CEA § 2(a)(1), 7 U.S.C. § 2. Yet the opinion does not determine any of the related issues cited on pages 3-5 of petitioners' reply brief. The court of appeals carefully stated that its opinion was "limited to the particular issue presented," App. at 50 n.50, which it defined as "whether the [SEC] has authority to regulate trading in options on [GNMA's]." App. at 1. The particular horrible paraded by petitioners in their reply brief—that the court of appeals' opinion will interfere with the Federal Reserve Board's ability to set margin requirements—was also presented to the court of appeals, which responded: "This opinion is not intended to decide related questions, such as . . . whether the Federal Reserve Board may set margin requirements for options on exempted securities . . . ." App. at 50 n.50; *see also* App. at 37 n.34.

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and

THE OPTIONS CLEARING CORPORATION,

Petitioners,

v.

BOARD OF TRADE OF THE CITY OF CHICAGO,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

MOTION OF THE SECURITIES INDUSTRY ASSOCIATION FOR LEAVE TO FILE A BRIEF AS *AMICUS CURIAE* IN SUPPORT OF THE PETITION AND BRIEF *AMICUS CURIAE* OF THE SECURITIES INDUSTRY ASSOCIATION

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IN THE

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October Term, 1982

No. 82-327

CHICAGO BOARD OPTIONS EXCHANGE, INCORPORATED

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THE OPTIONS CLEARING CORPORATION,

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v.

BOARD OF TRADE OF THE CITY OF CHICAGO,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

MOTION OF THE SECURITIES INDUSTRY ASSOCIATION FOR LEAVE TO FILE A BRIEF AS *AMICUS CURIAE* IN SUPPORT OF THE PETITION

The Securities Industry Association (the "SIA") hereby respectfully moves, pursuant to Rules 36.1 and 42 of the Court, for leave to file the attached brief *amicus curiae* in order to present its views on the jurisdictional question concerning which federal agency has jurisdiction over options on certain securities defined as exempt securities under Section 3(a)(12) of the Securities Exchange Act of 1934, 15 U.S.C. § 78c(a)(12)(1976) and whether options on such securities fall under the definition of the term "security" as found in Section 3(a)(10) of the Securities Exchange Act of 1934, 15 U.S.C. § 78c(a)(10)(1976).

The SIA believes that the court below erred in its conclusion on both these questions and contends the judgment of that Court should be reversed.

The SIA is a national trade association representing approximately 500 brokers and dealers responsible for over 90 percent of the nation's investment banking and securities brokerage business. The SIA is generally recognized as the primary public spokesman for the securities industry and the two questions before the Court are of vital importance to its members. The firms comprising the SIA's membership are located across the nation.

Many of the SIA's members provide both securities brokerage and commodities services to their customers. A clear, coherent, and predictable regulatory scheme is essential to optimizing the quality and quantity of services our members provide to their securities brokerage and commodities customers. This case presents issues which are of crucial importance to our members—that is, whether the securities or commodities statutes, rules, and regulations apply when our members are effecting transactions involving a particular investment vehicle.

If options on certain securities are construed not to be securities, our members would be tremendously impacted. The sale of such options would no longer have to comply with the registration provisions of the Securities Act of 1933, 15 U.S.C. § 77e (1976). Credit extended in connection with the purchase of such options would not be governed by the Federal Reserve Board's Regulation T, 12 C.F.R. § 220.3(i). Option purchasers would no longer be covered by the Securities Investor Protection Act of 1970, 15 U.S.C. §§ 78aaa-78lll (1976). Concerning the jurisdictional issue, should the decision below not be reversed, the Securities and Exchange Commission would

no longer regulate certain segments of our members' business involving the purchase and sale of options. In short, the entire statutory and regulatory framework by which the SIA's members operate would be drastically affected.

The SIA determined to submit to the court an *amicus curiae* brief after a careful review of the Seventh Circuit's decision and the petitioners' brief. A review of these materials indicated to the SIA that although petitioners' petition for a writ of certiorari thoroughly addresses many of the legal issues involved, the brief did not, naturally, focus on the impact of the decision below on the brokerage community. Accordingly, the SIA's brief focuses on the legal issues involved and the immediate impact the decision below will have on the brokerage community at large. The SIA also filed as *amicus curiae* in support of petitioners' request for a hearing *en banc* by the U.S. Seventh Circuit Court of Appeals.

Respectfully submitted,

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Questions Presented

The two questions presented by the Petition for a Writ of Certiorari are as follows:

1. Are standardized securities options (*i.e.*, options to purchase or sell a specified underlying security) which are widely offered and sold to the public through prospectuses and traded on a national securities exchange subject to regulation by the Securities and Exchange Commission under the federal securities laws?

2. If so, are such options subject to the exclusive jurisdiction of the Commodities Futures Trading Commission under the Commodity Exchange Act whenever the underlying securities are the subject of futures contracts traded on a commodity board of trade?

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IN THE

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No. 82-327

CHICAGO BOARD OPTIONS EXCHANGE, INCORPORATED

and

THE OPTIONS CLEARING CORPORATION,

Petitioners,

v.

BOARD OF TRADE OF THE CITY OF CHICAGO,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF OF THE SECURITIES INDUSTRY ASSOCIATION AS *AMICUS CURIAE*

This brief is filed pursuant to Rules 36.1 and 42 of this Court in support of the petition for certiorari filed by the Chicago Board Options Exchange, Incorporated (the "CBOE") and the Options Clearing Corporation (the "OCC") in No. 82-327.[1] On August 25, 1982, Petitioners timely filed a Petition for Certiorari with this Court.

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[1] Because the respondent did not consent to the filing of this brief, *amicus* filed a motion for leave to file the brief and the motion accompanies the proposed brief.

The text of Sections 2(a)(1) and 4(c) of the Commodity Exchange Act ("CEA"), 7 U.S.C. §§ 2, 6c, and Sections 3(a), 5, 6(b), 9, 17A(b)(1), 19(b)(1), and 25(a) of the Securities Exchange Act

(footnote continued on following page)

Interest of the Securities Industry Association as *Amicus Curiae*

The Securities Industry Association (the "SIA") is a trade association representing approximately 500 brokers and dealers responsible for over 90 percent of the nation's investment banking and securities brokerage business. The SIA is generally recognized as the primary public spokesman for the securities industry and the two questions before the Court are of vital importance to our members. Many of the SIA's members are regulated by both the Securities and Exchange Commission (the "SEC" or the "Commission") and the Commodities Futures Trading Commission (the "CFTC"); both our membership and the investing public are severely disadvantaged by the decision below which results in confusion over which investment products are regulated by which agency and which statutory scheme outlines the duties and responsibilities of our members as well as the rights and remedies of customers utilizing our members' services.

Statement

Petitioner CBOE has, since 1973, been a registered national securities exchange by an order of the SEC in accordance with Section 6 of the Exchange Act.[2] The CBOE maintains an exchange market for the trading of listed options.

The options traded by the CBOE are issued by petitioner OCC and are offered by prospectus. Until the Seventh

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(footnote continued from preceding page)

of 1934 ("Exchange Act"), 15 U.S.C. §§ 78c(a), 78e, 78f(b), 78i, 78q-1(b)(1), 78s(b)(1) and 78y(a) and other statutory provisions are set forth in the appendix to the Petition For a Writ of Certiorari of the CBOE and the OCC.

[2] Unless exempted, Section 6 requires exchanges, as defined in Exchange Act Section 3(a)(1), 15 U.S.C. § 78c(a)(1) (1976), to be registered with the SEC as a "national securities exchange."

Circuit's opinion questioned their legal status, such options were regarded as securities which were registered, offered, and sold pursuant to Section 5 of the Securities Act of 1933 ("Securities Act").[3] The OCC is responsible for clearing such options transactions and is registered as a securities clearing agency in accordance with Exchange Act Section 17A(b)(1).[4]

Petitioner CBOE had, in accordance with Exchange Act Section 19(b)(1),[5] filed in April 1980 proposed amendments to its option rules to provide for trading of options on mortgage backed securities of the Government National Mortgage Association ("GNMAs").[6] GNMA securities are issued by private institutions and are secured by pools of mortgages and are guaranteed by the Government National Mortgage Association.

The SEC published the CBOE's proposed rules for comment and received over eighty comment letters. Commentators, with the exception of the Board of Trade of the City of Chicago (the "CBT"), generally supported the CBOE's proposals.

In February 1981, the SEC entered an order approving the CBOE's proposed rules.[7] Also in February 1981, the

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[3] Because options are securities, the issuer (the OCC) must comply with the registration requirements of the Securities Act, 15 U.S.C. § 77e (1976).

[4] Unless exempted, clearing agencies, as defined in Exchange Act Section 3(a)(23), 15 U.S.C. § 78c(a)(23)(1976), are required to be registered with the SEC.

[5] Exchange Act Section 19(b)(1), 15 U.S.C. § 78s(b)(1)(1976), provides that exchanges must file proposed rule changes with the SEC and that interested persons shall be given an opportunity to comment on proposed rule changes.

[6] Notice of the proposed rule change was given by SEC Exchange Act Release No. 16801, 45 Fed. Reg. 32458 (1980).

[7] SEC Exchange Act Release No. 17577, 46 Fed. Reg. 15242 (1981).

OCC filed proposed rules concerning the issuance and clearance of GNMA options.[8] Again, only the CBT filed comments opposing the OCC's proposed rules.

In August 1981, the SEC entered an order approving the OCC's proposed rules changes.[9] The OCC then filed a supplement to its prospectus in accordance with Section 8 of the Securities Act. The supplement described options trading in GNMAs and was declared effective on October 30, 1981.

Claiming it was a person aggrieved by a final order of the Commission, the CBT filed petitions to review the Commission's order with the Seventh Circuit Court of Appeals.[10]

Decision of the Court Below

On March 24, 1982, a split panel of the Seventh Circuit Court of Appeals set aside the Commission's order approving the CBOE's proposal to trade GNMA options.[11] After an extensive analysis of the legislative history of the Commodity Exchange Act (the "CEA"),[12] the court held that the CFTC had exclusive jurisdiction over options on commodities, and stated that because of the prior trading of a

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[8] Notice of the proposed rule change was given in SEC Exchange Act Release No. 17598, 46 Fed. Reg. 16013 (1981).

[9] SEC Exchange Act Release No. 18015, 46 Fed. Reg. 40849 (1981).

[10] Exchange Act Section 25(a)(1), 15 U.S.C. § 78y(a)(1) (1976), provides, in part, that persons aggrieved by an SEC order may obtain review in the appropriate Court of Appeals.

[11] *Board of Trade of the City of Chicago* v. *Securities and Exchange Commission, et al.*, 677 F.2d 1137 (7th Cir. 1982) (hereinafter, *CBT* v. *SEC*).

[12] 7 U.S.C. §§ 1-24 (1980).

GNMA futures contract, the CFTC had exclusive jurisdiction over the trading of GNMA options.[13]

The majority's opinion focused on the language of the 1974 and 1978 amendments to the CEA. Specifically, the issue was whether Section 2(a)(1)[14] of the CEA gave the CFTC exclusive jurisdiction over options on commodities. The same legislation specifically stated that it should not be deemed to, "supercede or limit the jurisdiction at any time conferred on the Securities and Exchange Commission . . . or restrict the Securities and Exchange Commission . . . from carrying out its duties."

In addition to the issues raised by the petitioners, a key issue was whether GNMAs—an exempt security because it is a U.S. guaranteed obligation—became a "commodity" when futures trading on GNMAs began in 1975 or whether GNMAs are commodities only when traded in a futures market.[15] Stated differently, does a "security" as defined in both the Securities Act and the Exchange Act become a commodity for *all* purposes—such as when options on it are traded—when futures trading begins. An affirmative answer has a profound effect on market participants, both broker-dealers and investors.

The majority opinion also held that options are not securities within the definition given in the Exchange Act.[16] This holding also has a tremendous effect on all market participants.

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[13] 677 F.2d at 1146.

[14] 7 U.S.C. § 2 (1980).

[15] Exchange Act Section 3(a)(12), 15 U.S.C. § 78c(a)(12) (1976), includes within the definition of exempt securities obligations which are guaranteed as to principal or interest by the United States or by a corporation in which the United States has a direct or indirect interest.

[16] 677 F.2d at 1156.

The dissent vigorously rejected the majority's reasoning. It stated that the conclusion that the SEC did not have jurisdiction was "extreme," and that Section 2(a)(1) of the CEA was designed "to grant exclusive jurisdiction over the trading of commodity *futures*, including options on such *futures* to the Commodity *Futures* Trading Commission" (emphasis in original).[17] Concerning the impact of the decision, the dissent stated, "the [majority's] strained analysis will gain no more attractive practical result in the real world than it has achieved conceptual triumph in the world of theory." [18]

Summary of Argument

The decision below misconstrues the definitional section of the CEA and will cause confusion in the regulatory scheme over options. Options on securities (such as GNMAs) have, historically, been offered and sold in accordance with the federal securities laws and subject to the rules and regulations of the SEC. A correct interpretation of the relevant statutes and rules will continue such regulation.

When amending the CEA in 1974 and 1978, Congress did not seek to limit the jurisdiction of the SEC over options on exempt securities. GNMAs, exempt securities under Exchange Act Section 3(a)(12), become commodities when they are traded for future delivery and only for that purpose. An option on a GNMA, therefore, is an option on a security subject to the SEC's jurisdiction and the transaction is covered by the federal securities laws. A security becomes a commodity (and therefore subejct to the CFTC's jurisdiction) solely for the purpose of completing the contract for future delivery.

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[17] *Id.* at 1168, 69 (Cudahy, J., dissenting).

[18] *Id.* at 1184.

ARGUMENT

I.

The Decision Below Will Cause Confusion in the Regulatory Scheme Over Financial Instruments.

In the last ten years, a multitude of financial products have been brought to market. The trading volume in both options and futures contracts has increased dramatically. Efficient operation of the financial marketplace depends, to a large extent, on a logical and coherent regulatory background. Broker-dealers, futures commission merchants, ("FCMs")[19] and investors are all affected by the court of appeals decision which leaves uncertain the regulatory framework of the marketplace.

The SIA's members are brokers and dealers, many of which have both securities and commodities operations. Because of the differences between securities and commodities laws and rules in areas such as margin,[20] registration[21] and suitability[22] requirements, the SIA's members have a

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[19] CEA Section 2(a)(1) defines FCMs as "individuals, associations, partnerships, corporations, and trusts engaged in the soliciting or in accepting orders for the purchase or sale of any commodity for future delivery on or subject to the rules of any contract market . . . ."

[20] *See* Exchange Act Section 7, 15 U.S.C. § 78g (1976) and Section 3(i) of the Federal Reserve Board's Regulation T, 12 C.F.R. § 220.3(i). The CFTC has no authority under the CEA to establish margin levels for commodity futures contracts.

[21] *See* note 3, *supra*.

[22] *See, e.g.*, SEC Exchange Act Release No. 15575, 44 Fed. Reg. 11876 (1979) which required securities options exchanges to adopt new sales practice rules prior to the listing of new option products. In SEC Exchange Act Release No. 16696, 45 Fed. Reg. 21420 (1980), the SEC approved the new rules.

strong interest in obtaining the Court's interpretation on the construction of the two federal statutory and regulatory schemes involved.

Our members also have an interest in the wide availability of financial products to their clients. Both the majority and the dissent recognized the value of an efficient options market for GNMAs to investors and others. Indeed, the CBOE had to demonstrate to the SEC that their product was in the public interest[23] in its proposal to trade options on GNMAs. The SEC deliberated on the proposal for a long period of time and concluded that the product was in the public interest.

The court of appeals decision results in stoppage of trading in a product (exchange traded options on GNMAs) which virtually all the commentators (mortgage bankers, among others) felt was needed. The victims of this time-consuming litigation are participants in the GNMA market, and ultimately people seeking mortgages backed by the Government National Mortgage Association. A decision by this Court is needed to prevent a repeat of such fruitless litigation.

Apart from the decision's immediate impact on which agency has the statutory authority to approve rules dealing with the trading of options on GNMAs, the decision calls into question the SEC's regulation of all options. Since 1973, the OCC has registered options on securities in accordance with the registration provisions of the Securities Act. According to the majority, a security (GNMAs) be-

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[23] Exchange Act Section 6(b)(5), 15 U.S.C. § 78f(b)(5) (1976), provides, among other things, an exchange shall not be registered as a national securities exchange unless the Commission determines that the rules of the exchange are "designed to . . . protect investors and the public interest . . . ."

comes a commodity when futures trading in it is initiated on a board of trade. Following the logic of the opinion of the Seventh Circuit, AT&T bonds would probably no longer be securities when and if futures trading on them begins.[24]

The majority also held that GNMA options are not securities. While admitting that GNMAs are securities, the court stated, "[e]xchange-formed off-set options . . . are not within the definition [of a security]" (footnote omitted).[25]

The impact of such a result is staggering. For example, in 1980 over 80 million options with a value in excess of $41 billion were traded on the CBOE and other exchanges. The majority's novel approach calls into question the appropriate regulatory scheme for all such trading and can only cause economic mischief to the major securities exchanges of this country and to the industry which the SIA represents.

Exchange Act Section 3(a)(10) defines the term security to include, "any . . . investment contract . . . for a security."[26] An option is a form of investment contract whether viewed technically or otherwise. Indeed, several courts have held that the definition of a security encompasses

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[24] The New York Futures Exchange has applied for permission to trade futures in AT&T bonds. *See* 46 Fed. Reg. 30844 (June 11, 1981). The majority's decision attempted to distinguish, to some extent, between traditional securities (stocks, corporate bonds) and "illegitimate" investment vehicles such as GNMAs. Such semantics does not provide a meaningful distinction. *See, CBT* v. *SEC* at 1171, n.10 (Cudahy, J., dissenting).

[25] 677 F.2d at 1156. This holding of the Seventh Circuit has far-reaching effects. For example, do the federal securities laws provide a right or remedy to an investor who purchased options based upon a company's financial statements? It is also inconsistent with several other court decisions. *See,* note 27, *infra.*

[26] 15 U.S.C. § 78c(a)(10) (1976).

exchange-traded options.[27] As this court stated in *SEC* v. *C.M. Joiner,*[28] in evaluating whether an instrument is an investment contract, "[t]he test . . . is what character the instrument is given in commerce by the terms of the offer, the plan of distribution and the economic inducements held out to be the prospect."[29] Clearly, options are given the character of securities in commerce, are traded on registered exchanges, and are offered to a large number of investors.

In addition to the decision's impact on the brokerage industry, the decision creates confusion and problems for investors. For example, which statutory scheme provides rights and remedies to a party injured by illicit trading practices involving options on securities? Prior to the court of appeals decision, the answer was clear—the federal securities laws.[30] The purchase or sale of an option on a security —exempt or otherwise—involved a transaction "covered" by the federal securities laws. The court of appeals decision results in the purchaser or seller of an option (clearly a security) on a GNMA (an exempt security) having no remedy under the federal securities laws.

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[27] In *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723 (1975) this Court, after reviewing the language of Exchange Act Section 3(a)(13), (definition of buy or sell) stated, "the holders of puts, calls, options, and other contractual rights or duties to purchase or sell securities have been recognized as 'purchasers' or 'sellers' of securities" 421 U.S. at 751. In *Mansbach* v. *Prescott, Ball & Turben,* 598 F.2d 1017 (6th Cir. 1979), the court stated that the Exchange Act's definition of a security, "clearly includes options to purchase or sell stock." *Id.* at 1026, n.40. *See also, Savino* v. *E.F. Hutton & Co.,* 507 F. Supp. 1225 (S.D.N.Y. 1981).

[28] *SEC* v. *C.M. Joiner Leasing Corp.,* 320 U.S. 344 (1943).

[29] 320 U.S. at 352-53. *Accord, Marine Bank* v. *Weaver,* 102 S. Ct. 1220, 1223 (1982); *SEC* v. *United Benefit Life Insurance Co.,* 387 U.S. 202, 211 (1967).

[30] *See Mansbach* v. *Prescott, Ball and Turben,* 598 F.2d 1017 (6th Cir. 1979) and text at note 27, *supra.*

Investors are affected in other ways. State securities laws provide rights and remedies for purchasers and sellers of securities. The Securities Investor Protection Act provides insurance for investors in securities.[31] Clearly, the transformation of an option on a GNMA into a commodity as well as holding an option not to be a security has a significant impact on the investing public at large.

All these factors lead to the conclusion that options on GNMAs are securities and should be regulated by the SEC. Such a decision is necessary to clarify the proper statutory and regulatory scheme over these, as well as numerous other, investment vehicles.

II.

The Decision Below Incorrectly Interprets Two Federal Statutes and Their Relationship to Each Other.

Securities and commodities markets are dynamic institutions, and lines between the two are often blurred. Congress, however, did attempt to apportion regulatory responsibility between the SEC and the CFTC, and the Seventh Circuit incorrectly interpreted the statutory apportionment.

Section 2(a)(1) of the CEA is the key provision. It provides that a commodity includes such traditional items as wheat, corn, oats and a host of other agricultural products. A commodity is also defined to include "all services, rights, and interests in which contracts for future delivery are presently or in the future dealt in." [32] This section gives the CFTC exclusive jurisdiction, "with respect to accounts,

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[31] 15 U.S.C. §§ 78aaa-78lll (1976).

[32] 7 U.S.C. § 2 (1980).

agreements (including . . . [transactions] commonly known to the trade as an 'option' . . .) and transactions involving contracts of sale of a commodity for future delivery . . . ." The statute further provides that it neither supercedes nor restricts the SEC's jurisdiction or authority and it does not govern transactions in "security rights . . . unless such transactions involve the sale thereof for future delivery conducted on a board of trade."

The court of appeals found that the language "options . . . involving contracts of sale for future delivery" should be construed broadly; this coupled with its view that somehow a security becomes a commodity for *all* purposes when traded for future delivery on a board of trade led to its conclusion that the SEC had no authority to approve the trading of exchange traded options on GNMAs.

The court of appeals misinterpreted the statute and Congress' intent. When defining the term commodity, Congress distinguished between agricultural products and "services, rights, and interests in which contracts for future delivery are presently or in the future dealt in." [33] The latter only become commodities when they are traded for future delivery and only for that purpose. A security (a GNMA, for example), therefore, becomes a commodity *solely* for the purpose of completing the contract for future delivery. For all other purposes—that is, when not traded for future delivery—they are securities whose purchases and sales are regulated by the federal securities laws and the rules and regulations promulgated thereunder.[34]

Secondly, the court of appeals interpreted the phrase "transactions involving contracts of sale of a commodity for

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[33] *Id.*

[34] *See* cases cited at note 27, *supra.*

future delivery" too broadly. The court held that GNMA options "involve" the futures trading of the underlying commodity. As the dissent noted, options on GNMAs are not options on futures contracts, which are a "commodity" and therefore within the jurisdiction of the CFTC. The dissent stated:

> As the legislative history of the CEA makes clear, Congress enacted the exclusive jurisdiction proviso of § 2(a)(1) [of the CEA] so that trading in commodity futures, and related activities with a direct nexus to futures trading, such as . . . *options on futures* contracts, would be subject to regulation by the CFTC only. But the same rationale *does not apply to options on actuals, which unlike options on futures, do not have any necessary connection with futures trading* (citation omitted) (emphasis added).[35]

The court of appeals pointed out that the agreement between the SEC and CFTC—which calls for SEC regulation of options on GNMAs—does not resolve the issues because, "the two agencies cannot . . . enlarge or relinquish their statutory jurisdiction" [36] (citations omitted). It is noteworthy, however, that the House Committee on Energy and Commerce, in its report recommending legislation to implement the SEC-CFTC jurisdictional accord, noted that the Seventh Circuit's opinion, "is not consistent with long-standing Congressional intent that the SEC has the sole authority to regulate options on all securities, including exempt securities." [37] Similarly, the Senate Committee on Banking, Housing, and Urban Affairs' Report

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[35] 677 F.2d at 1169 (Cudahy, J., dissenting).

[36] *Id.* at 1142, n.8.

[37] H.R. Rep. No. 626, 97th Cong., 2nd Sess. Part 1 at 3 (1982).

stated that the SEC's authority extends to put and call options on securities and that options, for purposes of the federal securities laws, "are considered to be within the definitions of 'security'." [38]

Conclusion

The Court should decide these important issues of federal law and resolve the confusion emanating from a misinterpretation of two federal statutes by the court of appeals. *Amicus* respectfully requests that the petition for the writ of certiorari be granted.

Respectfully submitted,

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[38] S. Rep. No. 390, 97th Cong., 2nd Sess. 3, 5 (1982). *See also*, 1 L. Loss, Securities Regulation 469 (2nd ed. 1961).